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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 634

THEODORE A. MEYERS and wife, ALICE V. MEYERS,
Petitioners

v.

THE UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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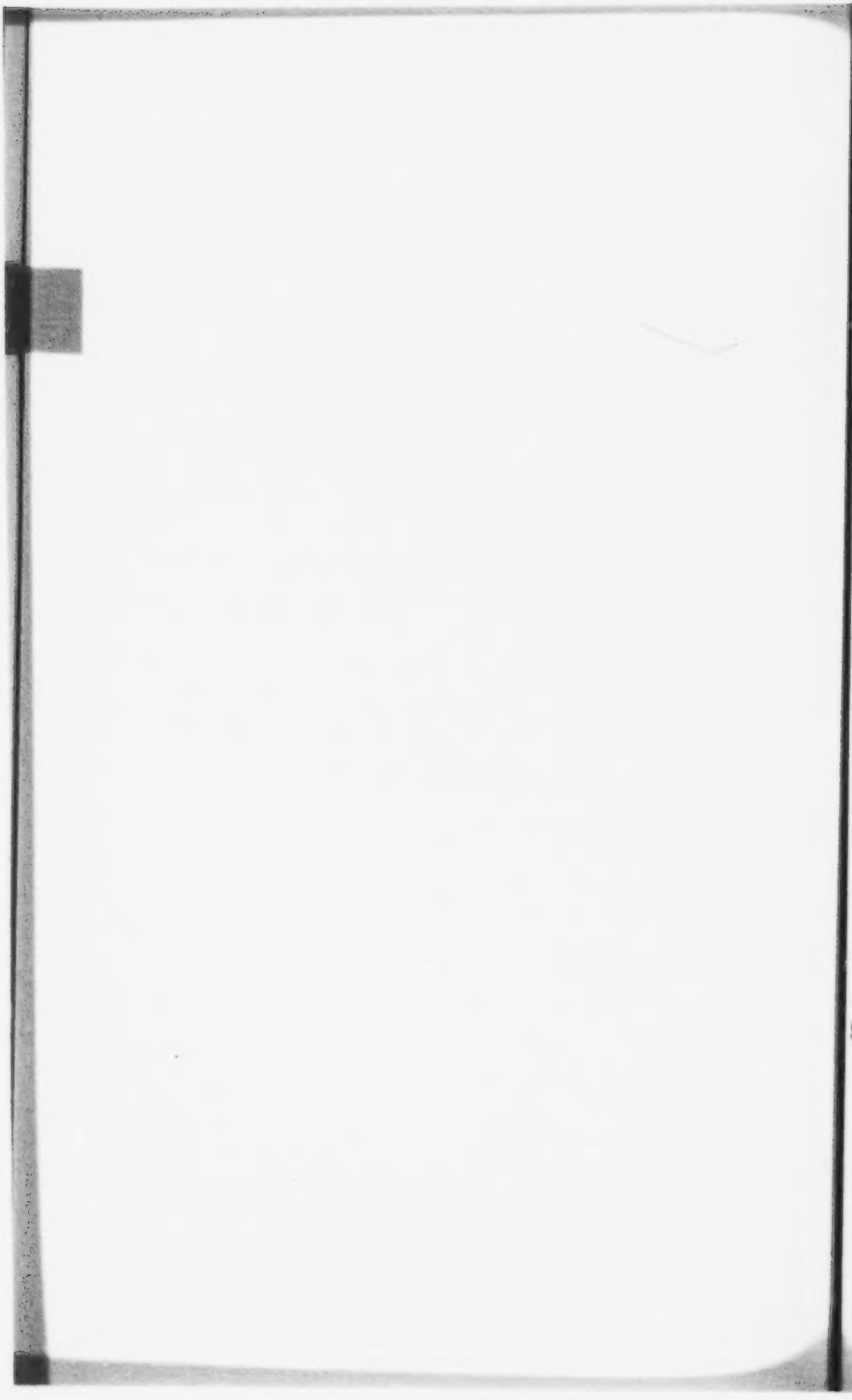

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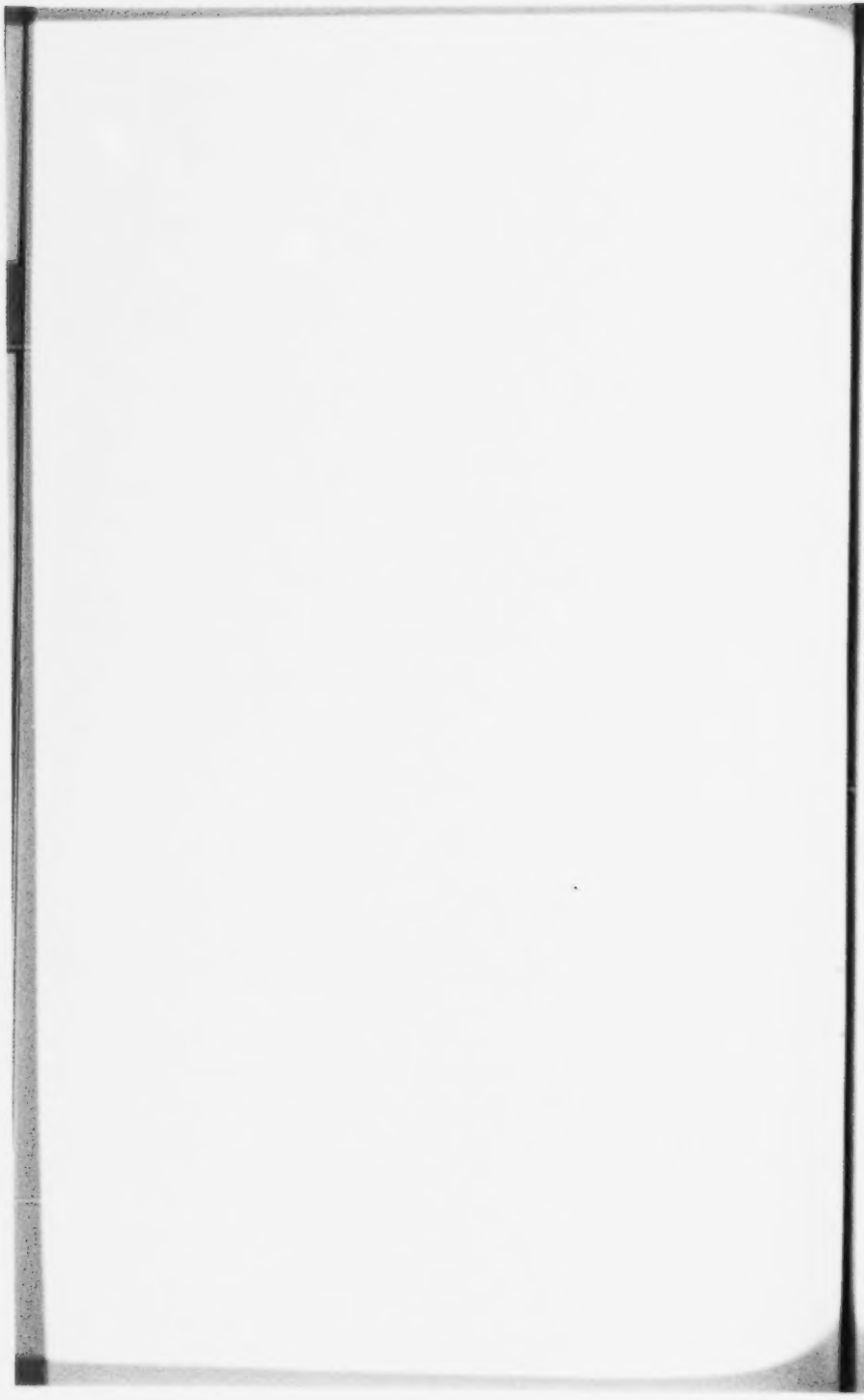

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THE UNITED STATES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Theodore A. Meyers and Alice V. Meyers, the petitioners, pray that a writ of certiorari issue to review the judgment of the United States Court of Claims in the above-entitled cause entered October 2, 1956.

OPINIONS BELOW

The opinions of the United States Court of Claims are printed at pages 1a through 20a of Appendix A to this petition. The reports of the Commissioner are printed at pages 20a through 31a of Appendix B to this petition.

Motion for re-hearing and order of the Court are printed at pages 32a and 33a of Appendix C to this petition.

Paragraph 8 of the stipulation of facts filed with the Court below are printed at pages 33a and 34a in Appendix D to this petition.

Exhibit A attached to the Statutory Notice of Deficiency is printed at pages 35a and 36a in Appendix E to this petition.

JURISDICTION

The judgment of the Court below was entered October 2, 1956 (App. A, page 33a infra). Jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

I. Whether the Court below, by its decision, sanctioned the taking of property in an arbitrary manner by upholding a patently defective net worth computation employed by the Commissioner of Internal Revenue in determining petitioners' income tax liability for the calendar year 1948.

II. Whether the increasing of petitioners' net worth for the calendar year 1948 by adding thereto a nonbusiness bad debt in the amount of $43,159.99, sustained in such year upon investments made in prior years and for which no deduction was claimed by petitioners, constitutes such an arbitrary determination and collection of taxes that, if permitted to stand, the judgment of the Court below would do violence to the concept of fairness and equality upon which our system of jurisprudence is founded.

III. Whether the Court below, by refusing to permit petitioners "to explain the discrepancies in the case," referred to by the Court below in its opinion, constitutes a substantial denial of due process of law.

STATUTES

The applicable provisions of the Internal Revenue Code (1939) are herein set forth.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes *gains* profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of interest in such property; also from interest rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. ***

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as

in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 51. INDIVIDUAL RETURNS.

(a) [as amended by Sec. 11(a) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231, and Sec. 202(c)(1) of the Revenue Act of 1948, c. 168, 62 Stat. 110] *Requirement.*—Every individual having for the taxable year a gross income of $600 or more shall make a return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury. Such return shall set forth in such cases, and to such extent, and in such detail, as the Commissioner with the approval of the Secretary may by regulations prescribe, the items of gross income and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as may be prescribed by such regulations.

(b) [as amended by Sec. 303 of the Revenue Act of 1948, *supra*] *Husband and Wife.*—

(1) *In general.*—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

* * * * *

(26 U. S. C. 1952 ed., Sec. 51)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

* * * * *

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) *Negligence.*—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272(i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

* * * * *

(26 U. S. C. 1952 ed., Sec. 293.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.54-1 [as amended by T. D. 5381, 1944 Cum. Bull. 188]. *Records and Income Tax Forms.* —Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Every organization exempt from tax under section 101 but required by section 54(f) to file an annual return shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts, and disbursements, and such other information as is required by section 29.101-2. The books or records required by this section shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.
>
> * * * * *

STATEMENT

On February 8, 1952, and without any prior notice thereof, the Commissioner of Internal Revenue filed liens against petitioners' real and personal property by virtue of a jeopardy assessment totaling $29,439.33 allegedly constituting a deficiency in income taxes, penalty and interest for the calendar year 1948 in the respective amounts of $24,052.82, $1,202.64, and $4,-

183.87. The total assessment was paid by petitioners on February 20, 1952.

On March 6, 1952, a statutory notice of deficiency (90-day letter) reflecting computations of income tax liability for 1948 and over-assessments for the years 1949 and 1950 was mailed to the petitioners. Attached to this notice of deficiency was a computation of net worth identified as Exhibit A (Appendix E). This computation clearly shows that the principal cause for the deficiency was the addition of the sum of $43,159.99 representing a non-business bad debt sustained by the petitioners in 1948 upon investments made by them in years prior to 1948. The over-assessments determined for the calendar years 1949 and 1950 were likewise determined by means of the net worth method. The deficiency for the year 1948 was asserted to be $24,-052.82 whereas the over-payments for the years 1949 and 1950 were ascertained to be $1,665.66 and $269.16 respectively.

On March 14, 1952, petitioners filed a claim for refund in the amount of $34,276.43 for the calendar year 1948. For the purpose of the proceeding in the Court below, petitioners claimed that the sum of $29,439.33 was wrongfully assessed and collected from them for the calendar year 1948.

Condensing the data contained in the net worth computation, it is found that petitioners allegedly understated their income in the years 1948 by $49,-394.63. Of this amount, $43,159.99 represented a non-business bad debt which was added to the petitioners' net worth for that year (Stips. Para. 8—Appendix D). The use of the net worth also results in the over-reporting of income by the petitioners for the years 1949 and 1950 in the respective amounts of $1,000 and $11,583.12.

As actually constructed, the net worth method could not result in a deficiency for the year 1948 in the amount presently existing, without also conceding that petitioners over-reported their income for the years 1949 and 1950. It becomes self-evident, of course, that by adding the sum of $43,159.99 (non-business bad debt) to petitioners' net worth in 1948 it actually forces into existence the deficiency as we now know it. Inasmuch as petitioners had not claimed this loss in the year 1948 or prior thereto, there is no question, therefore, as to whether or not such a loss should or should not be allowed.

REASONS FOR GRANTING THE WRIT

1. In sustaining the method of assessing and collecting income taxes for the calendar year 1948, the Court below has actually sanctioned the arbitrary and capricious use of authority in contravention of well established concepts inherent in our form of government.

2. It is apparent that the net worth method employed by the Commissioner of Internal Revenue is incorrect. This is so not only because a non-business bad debt in the amount of $43,159.99 was added to petitioners' net worth in 1948, but also because petitioners' assets and liabilities remained relatively constant for the period in question. This fact is more graphically illustrated in the following summary:

	12/31/47	12/31/48	12/31/49	12/31/50
Total Assets	$217,731.74	$192,606.10	$211,469.12	$206,749.43
Total Liabilities	35,052.32	34,256.00	33,401.08	31,854.41

3. The most significant feature impugning the accuracy of the net worth and which unquestionably demonstrates that petitioners are entitled to recover is the fact that a non-business bad debt sustained by them in the year 1948 was added to their net worth by the Commissioner of Internal Revenue in arriving at a deficiency for that year (App. E). This bad debt (loss) resulted from investments made by petitioners in prior years and the fact that it became worthless in 1948 should not serve as a justification on the part of the Commissioner of Internal Revenue to add it to petitioners' net worth at the end of 1948.

4. Aside from the fact that the sum of $43,159.99 has been erroneously added to petitioners' net worth in computing a deficiency, the net worth itself is not immune from criticism in other respects. The net worth reflects decreases in petitioners' net worth for the two years following that for which a deficiency had been determined. Presumably, the starting point was inaccurately ascertained; otherwise, the resulting computations would not be in opposition to each other. That is, a net worth does not increase and decrease and yet have the assets and liabilities remain relatively constant during the period. That is, it does not do so unless a mistake of some kind has been made. The principle that the starting point of a taxpayer's net worth must be clearly and accurately established has been recognized in other decisions. *Brodella* v. *United States,* 184 Fed. 2d 823 C.C.A. 6 (1950) This same principle was announced by this Court in the case of *Holland* v. *United States,* 348 U.S. 121, when, among other things, it stated, ". . . that an essential condition of this type of case (net worth) is the establishment with reasonable certainty of an opening net worth."

As to whether or not the burden of proof can be shifted upon petitioners under the circumstances prevailing herein, the Supreme Court of the United States, in the case of *Helvering* v. *Taylor,* 293 U.S. 507, said:

> "We find nothing in the statutes, the rules of the Board or our decisions that gives any support to the idea that the Commissioner's determination shown to be without rational foundation and excessive will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount . . ."

Allied to this principle is that expressed by the Court of Appeals for the First Circuit in the case of *Thomas, Constantine, et al.* v. *Commissioner,* C.C.A. 1 (decided April 12, 1956, Prentice-Hall, Para. 72,592). In reversing the Tax Court of the United States on the question of the amount of cash on hand at the beginning of the net worth computation, the Court of Appeals commented upon certain passages contained in the opinion of the Tax Court. Those passages and the comment of the Court of Appeals are herewith set forth:

PASSAGES

> "The deficiencies were determined upon the assumption that Thomas had no cash on hand on January 1, 1943. The burden is upon the petitioners to prove the amount of cash on hand."

> "The record is at least equally consistent with the conclusion that he had no cash. The petitioners have shown no basis for a finding that they had any cash on hand at any of the critical dates, and accordingly we must sustain the respondent as to that matter."

COMMENT

"We believe that these quoted passages do not correctly state the law. The presumption which favors the determinations of the Commissioner is not to be regarded as meaning that any arbitrary figure assigned to the cash on hand account without support in the record must nonetheless be treated as conclusive in the absence of an affirmative showing by the taxpayer of the correct amount . . ."

CONCLUSION

Not only is the decision of the Court below clearly erroneous, it also espouses the proposition that losses are equivalent to taxable income and are subject to taxation when inserted in a net worth method even though no tax advantage had inured to the benefit of the taxpayer sustaining the loss. The premises being considered, therefore, petitioners earnestly pray that this honorable Court review the judgment of the United States Court of Claims.

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APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF CLAIMS

No. 581-52

(Decided October 4, 1955)

THEODORE A. MEYERS AND WIFE, ALICE V. MEYERS v. THE UNITED STATES

Mr. Ellsworth T. Simpson for the plaintiffs.

Mr. H. S. Fessenden, with whom was *Mr. Assistant Attorney General H. Brian Holland,* for the defendant. *Messrs. Andrew D. Sharp* and *Ellis N. Slack* were on the brief.

LITTLETON, Judge, delivered the opinion of the court:

The plaintiffs[1] sue to recover $29,439.33, representing income tax deficiency, negligence penalty and interest thereon, for the calendar year 1948, and $269.16, with interest thereon, which sum represents a conceded overpayment for the calendar year 1950. The issue presented is whether the Commissioner of Internal Revenue properly employed the net worth method in determining plaintiff's income tax liability for the calendar year 1948. The plaintiff challenges the propriety of the use of the net worth method under the circumstances of this case and also the defendant's determination of cash on hand on December 31, 1947, by the use of that method.

From 1925 to 1934, the plaintiff operated gambling establishments in Washington, D. C. From 1937 to September 1947, the plaintiff operated a gambling establishment in

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[1] Mr. and Mrs. Meyers filed joint returns for the years in question. Since it was Mr. Meyers' activity that resulted in the controversy, he will, for convenience, be hereafter referred to as the plaintiff.

Maryland. At this latter place of business plaintiff employed from 10 to 35 people and specialized in dice, horses and blackjack. His establishment was open daily from 1:00 p. m. to 6:00 a. m., and he served food and drink. He established a loss limit of $2,000 for each race and sometimes accepted wagers on as many as 30 races daily. He estimated that he needed about $100,000 working capital to cover bets.

In May 1948, plaintiff loaned Walter Novak $19,000 to open a gambling business in Maryland, known as Rockway Towers. This business had been in operation for about five weeks when it was raided on June 5, 1948. The plaintiff was arrested, with others, charged, found guilty and received a prison sentence of one year. The plaintiff was in prison the latter part of 1948 and the first part of 1949. During this period the Bureau of Internal Revenue examined the plaintiff's return for 1942 through 1947. These returns had been filed on a cash and calendar year basis. After investigation, preparation of a partial net worth statement and conferences with the plaintiff, his returns for those years were accepted as correct.

The plaintiff had no gambling income in 1948 after his arrest on June 5. On his return for 1948, he reported $56,600 as income from wagering and testified that this represented successful private bets on the horses. His 1948 return disclosed taxable net income of $22,489.87 and a tax liability of $4,837.10. His return for 1949 disclosed a taxable net income of $27,768.49 and a tax liability of $6,688.88. His return for 1950 disclosed a net taxable income of $3,346.88 and a tax liability of $269.16, a five percent delinquency penalty of $13.46, and one month's interest of $1.35, or a total of $283.97.

During the latter part of 1951 and the early part of 1952, plaintiff's returns for 1948, 1949, and 1950 were examined by agents of the Bureau of Internal Revenue. For the year 1948, the Commissioner, employing the net worth method, found unreported income of $49,394.63. A deficiency for 1948 in the amount of $24,052.82 and a five percent negli-

gence penalty of $1,202.64 were determined. These sums, with interest thereon of $4,183.87, were assessed and the total of $29,439.33 was paid on February 20, 1952. Over-assessments were found by the same method for 1949 and 1950. The overpayment for 1949 has been refunded and the overpayment for 1950 is conceded. The plaintiff filed a timely claim for refund for 1948. More than six months have elapsed without any action by the Commissioner and this suit followed.

The necessity and danger of the net worth method of determining unreported income was fully discussed by the Supreme Court in *Holland* v. *United States*, 348 U. S. 121. The plaintiff contends that the use of the net worth method in determining his income for the year 1948 was improper and arbitrary. He contends that his records were adequate and that the sole reason for the use of the method was because the Commissioner had erroneously classified him as a racketeer, when in fact he had not engaged in the gambling "business" during the taxable year 1948. The revenue agent testified that the reason why plaintiff's income was determined by the use of the net worth method was because substantially all his income was received from gambling activity. For the taxable year the plaintiff reported as income $56,600 as his net winnings from gambling. He stated that he won this money by successful betting on the horses. His record reflecting his winnings and losses consists of a piece of paper setting forth certain dates with the amount he won or lost on those dates. This record may or may not have been complete. The Commissioner decided that it was incomplete, based on his computation of plaintiff's income by the use of the net worth method. The necessity of establishing the incompleteness or inadequacy of the taxpayer's records is not a condition precedent to the use of the net worth method. The net worth technique is a method of determining income which may be employed by the Commissioner in his discretion, *Holland* v. *United States, supra.* Whether or not the court will agree with the Commissioner's determination that there is unreported income is another question.

If an increase in net worth is established for the taxable year and the facts are such that give rise to an inference that this increase was income, the method is appropriate. The determination and assessment of the Commissioner in such cases is presumed to be correct. When suing for a refund the taxpayer must not only prove that the Commissioner's determination is wrong, but also must prove the facts upon which the correct tax can be determined. *Reinecke* v. *Spaulding*, 280 U. S. 227; *Helvering* v. *Taylor*, 293 U. S. 507, 514; *Decker et al.* v. *Korth*, 219 F. 2d 732, 737; *Harvey* v. *Early et al.*, 189 F. 2d 169, 171.

We turn now to the Commissioner's determination based upon the net worth method, that plaintiff had unreported income for the calendar year 1948 in the amount of $49,394.63. The plaintiff takes issue with the Commissioner on only one item. That item is the cash on hand on December 31, 1947. The plaintiff contends that he had cash on hand in excess of $70,000. The Commissioner found that he had $19,211.39 cash on hand. The only evidence that plaintiff had $70,000 cash on hand on December 31, 1947, is his own testimony. The $19,000 that he loaned Walter Novak in May 1948, could have been taken out of plaintiff's reported winnings of $39,000 on January 22, 1948. The $40,000 cash used to pay taxes in 1948 was taken into account in the Commissioner's net worth statement. Also, the Commissioner reduced the cash on hand on December 31, 1948, to zero, which had the effect of reducing the plaintiff's income for that year.

On the other hand, the evidence in the record to support the defendant's position that the plaintiff only had $19,211.39 cash on hand on December 31, 1947, is very weak. Revenue Agent Thomas, who examined plaintiff's returns for 1948, 1949, and 1950, testified that Revenue Agent Kennedy, who examined plaintiff's returns for the years 1943 through 1947, had prepared a partial net worth statement to check those returns which reflected cash on hand on December 31, 1942, of $50,000. In computing plaintiff's income for

1948, Thomas used Kennedy's $50,000 figure as the cash on hand on December 31, 1942, and by ascertaining the income plaintiff reported each year and the other undisputed changes in plaintiff's net worth arrived at the $19,211.39 figure as cash on hand on December 31, 1947. The plaintiff does not dispute Thomas' computation assuming the correctness of $50,000 cash on hand on December 31, 1942. But the plaintiff testified that he had cash on hand on December 31, 1942, in the amount of $100,000, which if worked through the same computation would result in the payment of the correct taxes for the intervening years and no deficiency for 1948. The plaintiff contends that Agent Kennedy's partial net worth statement shows $40,000 as cash on hand on December 31, 1947.

Although Agent Thomas used Agent Kennedy's net worth statement to ascertain the cash on hand on December 31, 1942, he could not remember whether or not the $40,000 figure was on that statement as the cash on hand on December 31, 1947. Also, although the defendant had been requested in open court to produce Agent Kennedy's partial net worth statement it failed to do so. Further it failed to call that agent as a witness, and objected to his testifying when plaintiff called him as his witness. The Commissioner sustained this objection. This was erroneous. On the evidence that is in the record, the partial net worth statement and the testimony of Agent Kennedy is necessary for either party to establish its case. No explanation whatsoever has been given by defendant as to how the $50,000 cash on hand as of December 31, 1942, was ascertained. Whether or not it was correct or the reason for it being $50,000 rather than $100,000 we do not know and have no way of determining because defendant has failed to put any evidence in the record to support it. The most important part of a net worth computation is the beginning net worth and the most important part of that is the cash on hand. Defendant has not offered a scintilla of evidence to support its cash on hand figure. The record as it stands therefore unequivocally

leaves the $50,000 determination in the category of being arbitrary. On the record defendant's determination lacks the presumption of correctness. The fact the defendant failed to put into evidence the proper proof to justify or support its determination to show that it was not arbitrary does not mean the plaintiff is entitled to recover. The evidence for the plaintiff is not clear or complete enough to justify a decision for him. The case cannot be disposed of without further proof.

The case is therefore remanded to the commissioner to take the testimony of Agent Kennedy relative to the cash on hand on December 31, 1947, and on December 31, 1942, and to have his partial net worth statement put in evidence and the taking of such further proof as either party may desire to offer, and for a supplemental report on the record so made.

It is so ordered.

LARAMORE, *Judge;* MADDEN, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and argument of counsel, and the report of Commissioner Marion T. Bennett, makes the following findings of fact:

1. During the years here involved plaintiffs were citizens of the United States and residents of Silver Hill, Maryland. They have filed joint Federal income tax returns for the years here concerned. Hereafter, for convenience, Mr. Meyers will be referred to as the plaintiff as his activities resulted in this controversy.

2. From 1925 to 1934 plaintiff operated gambling establishments in Washington, D. C.

3. From 1937 to September 1947 plaintiff operated a gambling establishment at Silver Hill, Prince Georges County, Maryland. He employed from 10 to 35 people and special-

ized in dice, horses, and blackjack. The gambling establishment was open daily from 1:00 p. m. to 6:00 a. m. and served food and drink. The plaintiff estimated that he had to have about $100,000 working capital to cover bets made at his place. He established a loss limit of $2,000 for each race and sometimes accepted wagers on as many as 30 races daily.

4. In May 1948, plaintiff loaned Walter Novak the sum of $19,000 with which to open a gambling business at a night club on the Baltimore Boulevard known as Rockway Towers. The gambling at Rockway Towers consisted of a dice game which was in operation from 9:00 p. m. to 2:30 a.m. This business had been in operation about five weeks when it was raided on June 5, 1948. The plaintiff was arrested along with 19 other men. They were charged, found guilty and received prison sentences of one year.

5. During the latter part of 1948 and early 1949, plaintiff's Federal income tax returns for the years 1942 to 1947, inclusive, were examined by agents of the Bureau of Internal Revenue. These returns were filed on a cash and calendar year base. No changes were made in the net taxable income reported on the returns filed for such years and the taxes computed and paid thereon.

6. The plaintiff had no gambling income in 1948 after his arrest on June 5. However, on his 1948 Federal income tax return he reported the sum of $56,600 as income from wagering and testified that this represented successful private bets on the horses. The 1948 return disclosed taxable net income of $22,489.87 and a tax liability of $4,837.10. As the taxpayers had paid $20,000 by payments on their 1948 declaration of estimated tax, the excess payment of $15,162.90 was refunded together with interest thereon of $37.30.

7. The return filed for the year 1949 disclosed taxable net income of $27,768.49 and a tax liability of $6,688.88 of which

$3,000 was paid on declaration of estimated tax and $3,688.88 was paid on April 3, 1950.

8. The return filed for the year 1950 disclosed a net taxable income of $3,346.88 and a tax liability of $269.16, a five percent delinquency penalty of $13.46 and one month's interest of $1.35 or a total of $283.97. Since the taxpayers had paid $1,200 on their reclaration of estimated tax, the excess of $916.03 was credited on the 1951 estimated tax.

9. The plaintiff's Federal tax returns for 1948, 1949, and 1950 were examined by agents for the bureau of Internal Revenue during the latter part of the year 1951 and the early part of 1952. The agents employed the so-called net worth method in determining a deficiency in 1948 in the sum of $24,052.82 in tax and $1,202.64 in penalty. These amounts together with interest thereon of $4,183.87 were assessed against plaintiff on February 8, 1952. The total of $29,439.33 was paid by plaintiff on February 20, 1952.

10. On March 6, 1952, a 90-day letter setting forth computations of tax liabilities for 1948, 1949, and 1950 was mailed to plaintiff. This letter disclosed an overassessment of $1,665.66 in tax for 1949 and $269.16 with $13.46 overassessment of penalty for 1950, a total of $1,934.82 exclusive of the $13.46. The net worth method was also used for these two years.

11. On March 14, 1952, plaintiff filed a claim for refund in the amount of $34,276.43 for the year 1948. Final action on this claim has not been taken by the Commissioner of Internal Revenue.

On April 11, 1952, plaintiff filed claims for refund for the years 1949 and 1950 for $1,665.66 and $269.16 respectively. The refund claim for 1949 together with interest of $58.03 was allowed and paid to plaintiff on November 12, 1952. Action on the refund claim for 1950 has been suspended because of the filing of this suit.

12. The agent of the Bureau of Internal Revenue resorted to use of the net worth method of estimating income tax liability because, in his opinion, the returns and the records furnished to support them were inadequate and because the principal source of income was from gambling. The records made available for verification of the sources of income and expenditures reported were the books of the Quonset Inn, a book on the operation of a tobacco farm in 1950, a sheet of paper approximately 3½" x 6" in size, torn from a notebook and showing in pencil certain notations described by plaintiff as his winnings and losses from wagering in 1948, with net winnings of $56,600, and some records on payment of interest. There were no bank statements, cancelled checks, check stubs or other records.

13. The claim for refund for 1948, referred to in finding 11 above, asked for a return of the $4,837.10 tax paid for that year (finding 6). It was alleged that through error the taxpayer had failed to claim the following deductions: Payment of Maryland income tax, $1,848.96; loss on stolen hogs, $1,500; and loss on financing the Quonset Inn, $43,159.99, a total of $46,508.95. The figure on the Quonset Inn was claimed as a business bad debt.

The claim also asked for refund of the sum of $29,439.33 representing additional taxes, penalty and interest assessed and paid as described in finding 9. The claim protested the jeopardy assessment and liens put upon the taxpayers' real and personal property because plaintiff was classed as a racketeer by the Bureau of Internal Revenue, the merit of this classification being denied. The determination of a deficiency by the net worth method was also attacked as arbitrary.

14. The revenue agent was unable to obtain any information concerning the claimed income of $5,051.95 from hog raising nor was he able to verify the inadequate records showing income from wagering of $56,600 in 1948. On the net worth statement prepared by the revenue agent no value

for hogs was included for 1948. By reason of such exclusion there would be no deductible loss from hog raising as claimed.

As to the claimed deduction of $1,848.96 for Maryland income taxes paid during 1948, this was allowed by the revenue agent in his net worth method of determining taxable income. By not adding this sum back to the net worth in 1948 it was unnecessary then to show the sum as a deduction in determining taxable net income under the net worth method since one adjustment would merely be an offset to the other.

15. In December 1946, plaintiff, although never a stockholder, loaned to the Quonset Inn, Inc., a restaurant and nightclub, the sum of $49,100. During the year 1947, plaintiff loaned further sums totaling $54,516.40 to the aforesaid corporation and in January 1948 he made a further loan of $10,000. As of February 1, 1948, the Quonset Inn was indebted to plaintiff in the total sum of $113,616.40, at which time he took over all the corporate assets and assumed its liabilities. On such date, February 1, 1948, the debt exceeded the net book value of the assets by $43,159.99. Plaintiff continued to operate the restaurant and nightclub as an individual proprietorship until April 30, 1949, at which time he sold its inventories of food and liquors and leased the equipment and premises to other parties at a stipulated rental. The business was not profitable when operated by the corporation or during the time plaintiff operated it as a single proprietorship, for he continued to advance funds to pay the debts incurred after taking over the assets and before April 30, 1949.

16. The Commissioner determined that the excess of $43,159.99 of the Quonset Inn debt to plaintiff as of February 1, 1948, over the net book value of the corporate assets, was a nonbusiness bad debt allowable as a capital loss deduction to plaintiff to the extent provided by the Internal Revenue Code. In the determination of plaintiff's taxable

income for the years 1948, 1949, and 1950, the Commissioner allowed the capital loss as a deduction from income up to the limit provided in the Internal Revenue Code of $1,000 for each of said years.

17. The detailed net worth statement attached to the deficiency notice of March 6, 1952, started as of December 31, 1942, since administrative files of the Internal Revenue Service disclosed a partial net worth statement was previously used when the determination was made to accept the returns filed by the taxpayers for the years 1943 through 1947 as correctly reporting income for such years. This statement disclosed that as of December 31, 1942, the taxpayers had cash on hand of $50,000. The revenue agent started his net worth statement with this amount of cash as of December 31, 1942, and adjusted cash on hand at the end of each year so that the net result would be the same amount of net taxable income as reported on the returns for each of the years 1943 through 1947. The net worth statement required $19.211.39 cash on hand as of December 31, 1947, to make the net income coincide with the $71,579.04 taxable income reported on the return filed for the year 1947 which was accepted without adjustment by the Commissioner of Internal Revenue. To give the taxpayers all possible benefits of cash, or the source of cash, it was reduced to zero as of December 31, 1948.

However, the defendant has failed to offer any evidence to support its determination of cash on hand on December 31, 1947, or December 31, 1942. The testimony of the revenue agent who examined plaintiff's returns for 1948, 1949, and 1950 based his beginning cash on hand figure on a revenue agent's earlier partial new worth statement. This earlier partial net worth statement was not put in evidence and there is no proof to support the correctness of the $50,000 cash on hand figure on December 31, 1942. The revenue agent who prepared the earlier partial net worth statement was not called by the defendant to explain how he arrived at the $50,000 figure.

18. If the Commissioner's determination of cash on hand on December 31, 1942, was correct, any increase in the cash on hand as of December 31, 1947, would result in an understatement of the taxable net income reported on the return for the year 1947 by the amount of such increase. Likewise, any increase of cash on hand as of December 31, 1948, would result in a like increase in taxable net income for the year 1948.

19. For the year 1948, the Commissioner found unreported income on the net worth basis of $49,394.63, and net overstatement of reported income of $1,000 for 1949, and $11,583.12 for 1950. The penalty assessed for the year 1948 was a negligence penalty of five percent of the deficiency under the provisions of Section 293 (a) of the Internal Revenue Code of 1939.

20. In computing the taxpayers' taxable net income of $71,884.50 for the year 1948 prior to deducting personal exemption and credit for dependents, there was added to the reduction in visible net worth of $24,329.32 between December 31, 1947 and December 31, 1948, Federal income tax paid during 1948, bail bond and attorney fees, nondeductible losses, personal checks of Mrs. Meyers, and estimated personal cash expenses, from which was deducted capital loss of $1,000. This resulted in the determination of an income tax liability of $28,889.92 for the year 1948. Since the taxpayers had reported a tax liability of $4,837.10, the deficiency in income tax due for the year was $24,052.82, upon which a five percent penalty of $1,202.64 was determined. The deficiency, and interest thereon of $4,183.87, together with the penalty or a total of $29,439.33, was paid by the taxpayers on February 20, 1952, as shown in finding 9.

21. The detailed net worth statement covering the years from 1942 to 1950, upon which the additional taxable income and deficiency were determined by the Commissioner for the year 1948 and overassessments for the years 1949 and

1950, is attached to exhibit I which has been received in evidence and is included herein by reference.

22. Plaintiff contests the decision of the revenue agent in concluding that there was only $19,211.39 in cash on hand as of December 31, 1947, and urges that the administrative file shows the sum of $40,000. This file was not offered in evidence. The figure of $40,000 is not established by the evidence.

The plaintiff says he is not liable for additional taxes, penalties, and interest in 1948, for which he claims a full refund, and further that his returns for 1948, 1949, and 1950 were true and correct and he is not entitled to refund for the two latter years, claims for such refunds having been filed upon defendant's instruction and to protect the plaintiff's statutory rights.

23. There is no proof that at the time here in question the plaintiff was dissipating his assets or about to leave the country, or that the assets were insufficient to pay the deficiency.

On the basis of the record, as it now stands, the use of the net worth method to determine plaintiff's income may be proper; however, defendant's determination of cash on hand on December 31, 1947, is not supported by any evidence in the record and is therefore arbitrary.

(Decided July 12, 1956)

Mr. Ellsworth T. Simpson for the plaintiffs.

Mr. Thomas Hogan, with whom was *Mr. Assistant Attorney General Charles K. Rice*, for the defendant. *Messrs Andrew D. Sharpe* and *H. S. Fessenden* were on the brief.

LITTLETON, *Judge*, delivered the opinion of the court:

The plaintiffs sue to recover $29,439.33, representing income tax deficiency, negligence penalty and interest thereon,

for the calendar year 1948, and $269.16, with interest thereon, which sum represents a conceded overpayment for the calendar year 1950. The law governing the case and the basic facts are set forth in the decision rendered by the court on October 4, 1955. The court held in that decision that there was no evidence supporting defendant's beginning cash on hand in its net worth statement and that plaintiff's evidence failed to furnish a basis for entering judgment in its behalf. The case was remanded to a commissioner of this court for the purpose of taking the testimony of agent Kennedy relative to the cash on hand as of December 31, 1942, and as of December 31, 1947, and to have his net worth statement put in evidence for the purpose of determining the cash on hand on January 1, 1948, and for a report thereon.

The testimony of Agent Kennedy was taken and the net worth statement used by him in examining plaintiffs' returns for the years 1942 through 1947 was put in evidence. The evidence shows that the net worth statement used by Agent Kennedy was prepared and given to him by plaintiff's attorney. This statement furnished by plaintiffs shows $50,000 cash on hand on December 31, 1942, and $40,000 cash on hand on December 31, 1947. The net worth statement of Agent Thomas shows $50,000 cash on hand on December 31, 1942, and $19,211.39 cash on hand on December 31, 1947. The evidence shows that the difference between the $40,000 cash on hand as of December 31, 1947, as shown by Agent Kennedy's net worth statement and the cash-on-hand figure of $19,211.39 as of January 1, 1948, as shown on the net worth statement by Agent Thomas, was the result of an error made by plaintiffs in the net worth statement furnished Agent Kennedy concerning loans made to one of plaintiff's businesses. When this error is corrected the net worth statements are not inconsistent.

The plaintiffs still contend that the defendant's use of the net worth method was arbitrary and that its determination that plaintiffs had $50,000 cash on hand on December 31,

1942, and $19,211.39 cash on hand on January 1, 1948, are arbitrary and not supported by the record.

However, the commissioner of this court, who heard the evidence and observed the demeanor of the witnesses, is made the judge of questions of fact and his findings are presumed to be correct. The commissioner has found in finding 10 that:

> Defendant's use of the figure of $50,000 cash on hand December 31, 1942, is supported by the evidence as reasonable under the circumstances described. The figure of $40,000 cash on hand December 31, 1947, is not supported by the evidence. Defendant's recomputation of the estimated cash on hand as of the latter date and use of the net worth method is supported by the evidence and is not arbitrary.

After an examination of the record, we agree with and adopt his finding. The element of closeness involved in this case is primarily due to the failure of the plaintiffs to come forward with facts peculiarly within their knowledge to explain the discrepancies involved in the case. The plaintiff's other contentions have been considered and found to be without merit.

Plaintiffs are not entitled to recover for the year 1948.

Plaintiffs are entitled to recover the conceded overpayment for 1950 in the amount of $269.16.

Judgment will be entered for plaintiffs in the amount of $269.16, with interest as provided by law.

It is so ordered.

LARAMORE, *Judge;* MADDEN, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge,* concur.

FINDINGS OF FACT

The court, having considered the evidence, the briefs and argument of counsel, and the supplemental report of Com-

missioner Marion T. Bennett, makes the following findings of fact:

1. Mr. E. Russell Kennedy, Jr., special agent for the Intelligence Division, Internal Revenue Service, began a preliminary inspection in late 1948 of the Federal income tax returns filed by plaintiffs for the years 1943 through 1947. This inspection was made to determine whether there were any indications of criminal fraud which would justify the institution of an investigation by the Intelligence Division. Plaintiff's counsel delivered to the special agent certain books and records of the plaintiffs which were examined along with the income tax returns. It is not now known which books and records were examined. Plaintiffs' counsel, at the request of the special agent, also submitted a net worth statement.

2. The net worth statement, which was furnished early in 1949 to defendant, covered the years 1943 through 1947. The special agent examined this statement, and the available records and returns, and discussed the same with plaintiffs' counsel over a period of several months. He discovered nothing which he felt would justify the institution of a full-scale criminal fraud investigation and, accordingly, terminated his inquiries.

3. The net worth statement referred to above disclosed that as of December 31, 1942, the plaintiffs had cash on hand of $50,000 and on December 31, 1947, had cash on hand of $40,000. The $50,000 cash-on-hand figure had an appreciable bearing upon the special agent's determination that no criminal fraud investigation should be commenced. In his view, if the plaintiffs did not have $50,000 cash on hand as of December 31, 1942, their income for the ensuing five years would have been $50,000 more than was shown by the net worth statement supplied by their counsel. If, on the other hand, they had more than $50,000 cash on hand on December 31, 1942, their income would have been less than that reflected by the net worth statement for the ensuing five years.

4. The special agent had no personal knowledge of what cash on hand plaintiffs had and made no independent examination for the purpose of determining it, other than by comparing the suggested figures with the returns and the plaintiffs' records and discussing the situation with their counsel on several occasions. Such comparison and discussion did not invalidate the cash-on-hand figures for the purposes for which the special agent was making an investigation.

5. A detailed net worth statement was attached to the deficiency notice of March 6, 1952, relating to plaintiff's taxable income for the years 1948, 1949, and 1950, started as of December 31, 1942, and was prepared to a large extent from the figures appearing on the original net worth statement which had been given to the special agent by plaintiffs' attorney early in 1949. This second net worth statement was prepared by Special Agent Charles E. Thomas who made no independent redetermination of the December 31, 1942, cash-on-hand figure. Agent Thomas used the same assets anl liabilities and although his net worth statement was more detailed than the one supplied by plaintiffs' counsel in 1949, both statements reflected items which were substantially the same for each of the years 1942 through 1946.

6. During the year ended December 31, 1947, the base year for purposes of determining plaintiffs' taxable income for the years 1948, 1949, and 1950, the investigation of Agent Thomas disclosed that Mr. Meyers had loaned sums totaling $54,516.40 to Quonset Inn, Inc. This sum is stipulated. During the previous year the sum of $49,100 was loaned to Quonset Inn, Inc. The 1949 net worth statement used by Agent Kennedy and plaintiffs' counsel refers to loans receivable of $43,676.40 in 1947. This item was in error on the 1949 net worth statement because it was understated by the sum of $46,940. Agent Thomas ascertained that the total loans made by Meyers to Quonset Inn, Inc., were as shown on the 1949 net worth statement for 1946 in the sum of $49,100. However, for 1947 it was found that the correct

total sum loaned was $90,616.40. This sum was carried as "Loans Receivable Quonset Inn, Inc.," by Agent Thomas in his own statement of plaintiffs' net worth. Both the statement of Thomas and the one used by Kennedy and plaintiffs' counsel prepared in 1949 show a Quonset Inn loan of $13,000 in 1947. Both net worth statements described the latter as a note receivable.

7. Agent Thomas included the omission described above in his detailed net worth statement before adjusting the plaintiffs' cash on hand based upon the income tax return filed for the year 1947. Upon the correction of the omission relating to the amount of cash loaned during 1947 to Quonset Inn, Inc., the plaintiffs' net worth statement supplied in 1949 would show and the detailed net worth statement made by Agent Thomas did show, a decrease in the available cash on hand as of December 31, 1947, from the sum of $40,000 first determined to the sum of $19,211.39. This action had the effect of increasing plaintiffs' income tax liability for 1948.

8. Agent Thomas requested that the plaintiffs and their counsel supply him with plaintiffs' books and records for the years 1948, 1949, and 1950. No cancelled checks or any other evidence of the plaintiffs' personal expenditures were made available. In these circumstances the agent secured transcripts of checks clearing plaintiffs' bank accounts during 1948, 1949, and 1950, totaled the amounts shown to have been spent by plaintiffs deducted from the total the amount of checks which he assumed were for business or other deductible expenses such as interest and taxes, and included the difference in his detailed net worth statement as "Personal Checks, Mrs. Meyers" and "Personal Checks, Mr. Meyers." No personal checks were listed on the detailed net worth statement for Mr. Meyers for the year 1948.

9. The plaintiffs, Mr. Meyers in particular, operated on a cash basis and at the end of each of the years 1948, 1949,

and 1950 Mr. Meyers maintained a net bank account balance of under $100. Therefore, Agent Thomas included in his net worth statement an item, "Estimated Cash Personal Expense." The second net worth statement used the $4,000 estimate of personal expense for 1947, set forth in the original net worth statement. For 1948 when no personal checks were charged back for Mr. Meyers, the sum of $2,000 was charged back as a cash personal expense. The sum of $4,500 was charged back to him for 1949 and $7,000 for 1950. It is not shown by the evidence how these sums were determined since the agent did not remember when he testified at the trial of the case. The same is true with respect to the amounts charged back to Mrs. Meyers. Plaintiffs challenge these items as arbitrary and excessive and as depressing refunds claimed due. These assertions were not made by plaintiffs in their refund claims. The refund claim for 1949 has been allowed and paid. Only 1948 and 1950 are in issue here. Overpayment of the sum of $269.16 for 1950 is conceded by the defendant. As to 1950 it is found plaintiffs purchased a Cadillac automobile. There is no evidence that it was paid for other than by cash except that a trade-in of undetermined value was involved. The sum of $500 which was added to plaintiffs' income in 1950 represented payment of an appraisal fee in connection with condemnation proceedings, the gain on which was reflected by plaintiffs in their income tax returns for 1950. There is no evidence that this fact was called to the attention of the revenue agents.

10. Defendant's use of the figure of $50,000 cash on hand December 31, 1942, is supported by the evidence as reasonable under the circumstances described. The figure of $40,000 cash on hand December 31, 1947, is not supported by the evidence. Defendant's recomputation of the estimated cash on hand as of the latter date and use of the net worth method is supported by the evidence and is not arbitrary.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover, and it is therefore adjudged and ordered that they recover of and from the United States two hundred sixty-nine dollars and sixteen cents ($269.16).

APPENDIX B

(Filed Feb. 1, 1955)

Report of Commissioner

To the honorable the CHIEF JUDGE AND ASSOCIATE JUDGES OF THE UNITED STATES COURT OF CLAIMS:

Pursuant to the order of reference in the above-entitled case the undersigned commissioner makes the following report of his findings of fact:

1. During the years here involved plaintiffs were citizens of the United States and residents of Silver Hill, Maryland. They have filed joint Federal income tax returns for the years here concerned. Hereafter, for convenience, Mr. Meyers will be referred to as the plaintiff as his activities resulted in this controversy.

2. From 1925 to 1934 plaintiff operated gambling establishments in Washington, D. C.

3. From 1937 to September 1947 plaintiff operated a gambling establishment at Silver Hill, Prince Georges County, Maryland. He employed from 10 to 35 people and specialized in dice, horses, and blackjack. The gambling establishment was open daily from 1:00 p.m. to 6:00 a.m. and served food and drink. The plaintiff estimated that he had to have about $100,000 working capital to cover bets made at his place. He established a loss limit of $2,000 for each race and sometimes accepted wagers on as many as 30 races daily.

4. In May 1948, plaintiff loaned Walter Novak the sum of $19,000 with which to open a gambling business at a night club on the Baltimore Boulevard known as Rockway Towers. The gambling at Rockway Towers consisted of a dice game which was in operation from 9:00 p. m. to 2:30 a. m. This business had been in operation about five weeks when it was raided on June 5, 1948. The plaintiff was arrested along with 19 other men. They were all charged, found guilty and received prison sentences of one year.

5. During the latter part of 1948 and early 1949, plaintiff's Federal income tax returns for the years 1942 to 1947, inclusive, were examined by agents of the Bureau of Internal Revenue. These returns were filed on a cash and calendar year base. No changes were made in the net taxable income reported on the returns filed for such years and the taxes computed and paid thereon.

6. The plaintiff had no gambling income in 1948 after his arrest on June 5. However, on his 1948 Federal income tax return he reported the sum of $56,600 as income from wagering and testified that this represented successful private bets on the horses. The 1948 return disclosed taxable net income of $22,489.87 and a tax liability of $4,837.10. As the taxpayers had paid $20,000 by payments on their 1948 declaration of estimated tax, the excess payment of $15,162.90 was refunded together with interest thereon of $37.30.

7. The return filed for the year 1949 disclosed taxable net income of $27,768.49 and a tax liability of $6,688.88 of which $3,000 was paid on declaration of estimated tax and $3,688.88 was paid on April 3, 1950.

8. The return filed for the year 1950 disclosed a net taxable income of $3,346.88 and a tax liability of $269.16, a five percent delinquency penalty of $13.46 and one month's interest of $1.35 or a total of $283.97. Since the taxpayers had paid $1,200 on their declaration of estimated tax, the excess of $916.03 was credited on the 1951 estimated tax.

9. The plaintiff's Federal tax returns for 1948, 1949, and 1950 were examined by agents for the Bureau of Internal Revenue during the latter part of the year 1951 and the early part of 1952. The agents employed the so-called net worth method in determining a deficiency in 1948 in the sum of $24,052.82 in tax and $1,202.64 in penalty. These amounts together with interest thereon of $4,183.87 were assessed against plaintiff on February 8, 1952. The total of $29,-439.33 was paid by plaintiff on February 20, 1952.

10. On March 6, 1952, a 90-day letter setting forth computations of tax liabilities for 1948, 1949, and 1950 was mailed to plaintiff. This letter disclosed an overassessment of $1,665.66 in tax for 1949 and $269.16 with $13.46 overassessment of penalty for 1950, a total of $1,934.82 exclusive of the $13.46. The net worth method was also used for these two years.

11. On March 14, 1952, plaintiff filed a claim for refund in the amount of $34,276.43 for the year 1948. Final action on this claim has not been taken by the Commissioner of Internal Revenue.

On April 11, 1952, plaintiff filed claims for refund for the years 1949 and 1950 for $1,665.66 and $269.16 respectively. The refund claim for 1949 together with interest of $58.03 was allowed and paid to plaintiff on November 12, 1952. Action on the refund claim for 1950 has been suspended because of the filing of this suit.

12. The agent of the Bureau of Internal Revenue resorted to use of the net worth method of estimating income tax liability because, in his opinion, the returns and the records furnished to support them were inadequate and because the principal source of income was from gambling. The records made available for verification of the sources of income and expenditures reported were the books of the Quonset Inn, a book on the operation of a tobacco farm in 1950, a sheet of paper approximately 3½″ x 6″ in size, torn from a notebook and showing in pencil certain notations described by

plaintiff as his winnings and losses from wagering in 1948, with net winnings of $56,600, and some records on payment of interest. There were no bank statements, cancelled checks, check stubs or other records.

13. The claim for refund for 1948, referred to in finding 11 above, asked for a return of the $4,837.10 tax paid for that year (finding 6). It was alleged that through error the taxpayer had failed to claim the following deductions: Payment of Maryland income tax, $1,848.96; loss on stolen hogs, $1,500; and loss on financing the Quonset Inn, $43,159.99, a total of $46,508.95. The figure on the Quonset Inn was claimed as a business bad debt.

The claim also asked for refund of the sum of $29,439.33 representing additional taxes, penalty and interest assessed and paid as described in finding 9. The claim protested the jeopardy assessment and liens put upon the taxpayer's real and personal property because plaintiff was classed as a racketeer by the Bureau of Internal Revenue, the merit of this classification being denied. The determination of a deficiency by the net worth method was also attacked as arbitrary.

14. The revenue agent was unable to obtain any information concerning the claimed income of $5,051.95 from hog raising nor was he able to verify the inadequate records showing income from wagering of $56,600 in 1948. On the net worth statement prepared by the revenue agent no value for hogs was included for 1948. By reason of such exclusion there would be no deductible loss from hog raising as claimed.

As to the claimed deduction of $1,848.96 for Maryland income taxes paid during 1948, this was allowed by the revenue agent in his net worth method of determining taxable income. By not adding this sum back to the net worth in 1948 it was unnecessary then to show the sum as a deduction in determining taxable net income under the net worth method since one adjustment would merely be an offset to the other.

15. In December 1946, plaintiff, although never a stockholder, loaned to the Quonset Inn, Inc., a restaurant and nightclub, the sum of $49,100. During the year 1947, plaintiff loaned further sums totaling $54,516.40 to the aforesaid corporation and in January 1948 he made a further loan of $10,000. As of February 1, 1948, the Quonset Inn was indebted to plaintiff in the total sum of $113,-616.40, at which time he took over all the corporate assets and assumed its liabilities. On such date, February 1, 1948, the debt exceeded the net book value of the assets by $43,-159.99. Plaintiff continued to operate the restaurant and nightclub as an individual proprietorship until April 30, 1949, at which time he sold its inventories of food and liquors and leased the equipment and premises to other parties at a stipulated rental. The business was not profitable when operated by the corporation or during the time plaintiff operated it as a single proprietorship, for he continued to advance funds to pay the debts incurred after taking over the assets and before April 30, 1949.

16. The Commissioner determined that the excess of $43,159.99 of the Quonset Inn debt to plaintiff as of February 1, 1948, over the net book value of the corporate assets, was a nonbusiness bad debt allowable as a capital loss deduction to plaintiff to the extent provided by the Internal Revenue Code. In the determination of plaintiff's taxable income for the years 1948, 1949, and 1950, the Commissioner allowed the capital loss as a deduction from income up to the limit provided in the Internal Revenue Code of $1,000 for each of said years.

17. The detailed net worth statement attached to the deficiency notice of March 6, 1952, started as of December 31, 1942, since administrative files of the Internal Revenue Service disclosed a partial net worth statement was previously used when the determination was made to accept the returns filed by the taxpayers for the years 1943 through 1947 as correctly reporting income for such years. This statement disclosed that as of December 31, 1942, the tax-

payers had cash on hand of $50,000. The revenue agent started his net worth statement with this amount of cash as of December 31, 1942, and adjusted cash on hand at the end of each year so that the net result would be the same amount of net taxable income as reported on the returns for each of the years 1943 through 1947. The net worth statement required $19,211.39 cash on hand as of December 31, 1947, to make the net income coincide with the $71,579.04 taxable income reported on the return filed for the year 1947 which was accepted without adjustment by the Commissioner of Internal Revenue. To give the taxpayers all possible benefit of cash, or the source of cash, it was reduced to zero as of December 31, 1948.

However, the defendant has failed to offer any evidence to support its determination of cash on hand on December 31, 1947, or December 31, 1942. The testimony of the revenue agent who examined plaintiff's returns for 1948, 1949, and 1950 based his beginning cash on hand figure on a revenue agent's earlier partial new worth statement. This earlier partial net worth statement was not put in evidence and there is no proof to support the correctness of the $50,000 cash on hand figure on December 31, 1942. The revenue agent who prepared the earlier partial net worth statement was not called by the defendant to explain how he arrived at the $50,000 figure.

18. Any increase in the cash on hand as of December 31, 1947, would result in an understatement of the taxable net income reported on the return for the year 1947 by the amount of such increase. Likewise, any increase of cash on hand as of December 31, 1948, would result in a like increase in taxable net income for the year 1948.

19. For the year 1948, the Commissioner found unreported income on the net worth basis of $49,394.63, and net overstatement of reported income of $1,000 for 1949, and $11,583.12 for 1950. The penalty assessed for the year 1948 was a negligence penalty of five percent of the deficiency

under the provisions of Section 293 (a) of the Internal Revenue Code of 1939.

20. In computing the taxpayers' taxable net income of $71,884.50 for the year 1948 prior to deducting personal exemption and credit for dependents, there was added to the reduction in visible net worth of $24,329.32 between December 31, 1947 and December 31, 1948, Federal income tax paid during 1948, bail bond and attorney fees, nondeductible losses, personal checks of Mrs. Meyers, and estimated personal cash expenses, from which was deducted capital loss of $1,000. This resulted in the determination of an income tax liability of $28,889.92 for the year 1948. Since the taxpayers had reported a tax liability of $4,837.10, the deficiency in income tax due for the year was $24,052.82, upon which a five percent penalty of $1,202.64 was determined. The deficiency, and interest thereon of $4,183.87, together with the penalty or a total of $29,439.33, was paid by the taxpayers on February 20, 1952, as shown in finding 9.

21. The detailed net worth statement covering the years from 1942 to 1950, upon which the additional taxable income and deficiency were determined by the Commissioner for the year 1948 and overassessments for the years 1949 and 1950, is attached to exhibit I which has been received in evidence and is included herein by reference.

22. Plaintiff contests the decision of the revenue agent in concluding that there was only $19,211.39 in cash on hand as of December 31, 1947, and urges that the administrative file shows the sum of $40,000. This file was not offered in evidence. The figure of $40,000 is not established by the evidence.

The plaintiff says he is not liable for additional taxes, penalties, and interest in 1948, for which he claims a full refund, and further that his returns for 1948, 1949, and 1950 were true and correct and he is not entitled to refund for the two latter years, claims for such refunds having been filed upon defendant's instructions and to protect the plaintiff's statutory rights.

23. There is no proof that at the time here in question the plaintiff was dissipating his assets or about to leave the country. It is found, however, that due to the nature of plaintiff's business and the inadequacy of his records to substantiate and identify the sources of his income, the defendant was justified in making a jeopardy assessment. Further, because of the aforesaid factors, it was necessary to make a net worth determination of plaintiff's tax liabilities for 1948, 1949, and 1950, and it is found that this was the normal course of procedure in the Bureau of Internal Revenue in such cases at the time. The determination so made was not unreasonable or arbitrary.

Plaintiff is entitled to recover for the year 1950 the sum of $269.16 representing an overpayment plus $13.46 which was collected as a penalty, together with interest as provided by law.

Respectfully submitted.

MARION T. BENNETT, *Commissioner.*

(Filed Feb. 24, 1956)

Supplemental Report of Commissioner

To the honorable the CHIEF JUDGE AND ASSOCIATE JUDGES OF THE UNITED STATES COURT OF CLAIMS:

Pursuant to the opinion of the court on October 4, 1955, the undersigned Commissioner makes the following supplemental report to his findings of fact filed on February 1, 1955:

1. Mr. E. Russell Kennedy, Jr., special agent for the Intelligence Division, Internal Revenue Service, began a preliminary inspection in late 1948 of the Federal income tax returns filed by the plaintiffs for the years 1943 through 1947. This inspection was made to determine whether there were any indications of criminal fraud which would

justify the institution of an investigation by the Intelligence Division. Plaintiff's counsel delivered to the special agent certain books and records of the plaintiffs which were examined along with the income tax returns. It is not now known which books and records were examined. Plaintiffs' counsel, at the request of the special agent, also submitted a net worth statement.

2. The net worth statement, which was furnished early in 1949 to defendant, covered the years 1943 through 1947. The special agent examined this statement, and the available records and returns, and discussed the same with plaintiffs' counsel over a period of several months. He discovered nothing which he felt would justify the institution of a full-scale criminal fraud investigation and, accordingly, terminated his inquiries.

3. The net worth statement referred to above disclosed that as of December 31, 1942, the plaintiffs had cash on hand of $50,000 and on December 31, 1947, had cash on hand of $40,000. The $50,000 cash-on-hand figure had an appreciable bearing upon the special agent's determination that no criminal fraud investigation should be commenced. In his view, if the plaintiffs did not have $50,000 cash on hand as of December 31, 1942, their income for the ensuing five years would have been $50,000 more than was shown by the net worth statement supplied by their counsel. If, on the other hand, they had more than $50,000 cash on hand on December 31, 1942, their income would have been less than that reflected by the net worth statement for the ensuing five years.

4. The special agent had no personal knowledge of what cash on hand plaintiffs had and made no independent examination for the purpose of determining it, other than by comparing the suggested figures with the returns and the plaintiffs' records and discussing the situation with their counsel on several occasions. Such comparison and discussion did not invalidate the cash-on-hand figures for the

purposes for which the special agent was making an investigation.

5. A detailed net worth statement was attached to the deficiency notice of March 6, 1952, relating to plaintiffs' taxable income for the years 1948, 1949, and 1950, started as of December 31, 1942, and was prepared to a large extent from the figures appearing on the original net worth statement which had been given to the special agent by plaintiffs' attorney early in 1949. This second net worth statement was prepared by Special Agent Charles E. Thomas who made no independent redetermination of the December 31, 1942, cash-on-hand figure. Agent Thomas used the same assets and liabilities and although his net worth statement was more detailed than the one supplied by plaintiffs' counsel in 1949, both statements reflected items which were substantially the same for each of the years 1942 through 1946.

6. During the year ended December 31, 1947, the base year for purposes of determining plaintiffs' taxable income for the years 1948, 1949, and 1950, the investigation of Agent Thomas disclosed that Mr. Myers had loaned sums totaling $54,516.40 to Quonset Inn, Inc. This sum is stipulated. During the previous year the sum of $49,100 was loaned to Quonset Inn, Inc. The 1949 net worth statement used by Agent Kennedy and plaintiffs' counsel refers to loans receivable of $43,676.40 in 1947. This item was in error on the 1949 net worth statement because it was understated by the sum of $46,940. Agent Thomas ascertained that the total loans made by Meyers to Quonset Inn, Inc., were as shown on the 1949 net worth statement for 1946 in the sum of $49,100. However, for 1947 it was found that the correct total sum loaned was $90,616.40. This sum was carried as "Loans Receivable Quonset Inn, Inc.," by Agent Thomas in his own statement of plaintiff' net worth. Both the statement of Thomas and the one used by Kennedy and plaintiffs' counsel prepared in 1949 show a

Quonset Inn loan of $13,000 in 1947. Both net worth statements described the latter as a note receivable.

7. Agent Thomas included the omission described above in his detailed net worth statement before adjusting the plaintiffs' cash on hand based upon the income tax return filed for the year 1947. Upon the correction of the omission relating to the amount of cash loaned during 1947 to Quonset Inn, Inc., the plaintiffs' net worth statement supplied in 1949 would show, and the detailed net worth statement made by Agent Thomas did show, a decrease in the available cash on hand as of December 31, 1947, from the sum of $40,000 first determined to the sum of $19,211.39. This action had the effect of increasing plaintiffs' income tax liability for 1948.

8. Agent Thomas requested that the plaintiffs and their counsel supply him with plaintiffs' books and records for the years 1948, 1949, and 1950. No cancelled checks or any other evidence of the plaintiffs' personal expenditures were made available. In these circumstances the agent secured transcript of checks clearing plaintiffs' bank accounts during 1948, 1949, and 1950, totaled the amounts shown to have been spent by plaintiffs, deducted from the total the amount of checks which he assumed were for business or other deductible expenses such as interest and taxes, and included the difference in his detailed net worth statement as "Personal Checks, Mrs. Meyers" and "Personal Checks, Mr. Meyers." No personal checks were listed on the detailed net worth statement for Mr. Meyers for the year 1948.

9. The plaintiffs, Mr. Meyers in particular, operated on a cash basis and at the end of each of the years 1948, 1949, and 1950 Mr. Meyers maintained a net bank account balance of under $100. Therefore, Agent Thomas included in his net worth statement an item, "Estimated Cash personal Expense." The second net worth statement used the $4,000 estimate of personal expense for 1947, set forth in the original net worth statement. For 1948 when no personal checks

were charged back for Mr. Meyers, the sum of $2,000 was charged back as a cash personal expense. The sum of $4,500 was charged back to him for 1949 and $7,000 for 1950. It is not shown by the evidence how these sums were determined since the agent did not remember when he testified at the trial of the case. The same is true with respect to the amounts charged back to Mrs. Meyers. Plaintiffs challenge these items as arbitrary and excessive and as depressing refunds claimed due. These assertions were not made by plaintiffs in their refund claims. The refund claim for 1949 has been allowed and paid. Only 1948 and 1950 are in issue here. Overpayment of the sum for 1950 is conceded by the defendant. As to 1950 it is found plaintiffs purchased a Cadillac automobile. There is no evidence that it was paid for other than by cash except that a trade-in of undetermined value was involved. The sum of $500 which was added to plaintiffs' income in 1950 represented payment of an appraisal fee in connection with condemnation proceedings, the gain on which was reflected by plaintiffs in their income tax returns for 1950. There is no evidence that this fact was called to the attention of the revenue agents.

10. Defendant's use of the figure of $50,000 cash on hand December 31, 1942, is supported by the evidence as reasonable under the circumstances described. The figure of $40,000 cash on hand December 31, 1947, is not supported by the evidence. Defendant's recomputation of the estimated cash on hand as of the latter date and use of the net worth method is supported by the evidence and is not arbitrary.

Respectfully submitted.

MARION T. BENNETT,
Commissioner.

APPENDIX C

Motion for Re-Hearing

Come now the plaintiffs, by their counsel, Ellsworth T. Simpson, and respectfully move this Honorable Court to grant a re-hearing in the above-entitled proceeding upon the grounds and for the reasons herein set forth:

1. In its opinion entered July 12, 1956, the Court stated that the element of closeness involved in this case is primarily due to failure of plaintiffs to come forward with facts peculiarly within their knowledge to explain the discrepancies involved in the case. The discrepancies referred to are presumed to be those relating to the item of cash on hand contained in the original net worth (defendant's Exhibit 1) and that which was determined by Revenue Agent Thomas which led to the filing of this suit.

2. Inasmuch as the counsel of record in this proceeding also acted as counsel for plaintiffs during the examination conducted by Special Agent Kennedy as well as that conducted by Agent Thomas, counsel for plaintiffs sought to obviate the necessity of testifying as a witness himself. Toward that end, Agent Kennedy was originally called by plaintiffs at the first hearing but upon objection by counsel for defendant, Agent Kennedy was not permitted to testify.

3. By order of this Court, defendant was required to call Agent Kennedy for the purpose of taking his testimony and a second hearing was held approximately one year later. A review of the record clearly indicates that the testimony of Agent Kennedy, who was now testifying in behalf of the defendant, was vague and indefinite relative to the vital question of the original net worth particularly as it related to the item of cash.

4. It is now evident that this Honorable Court has placed considerable stress upon this most important point and, therefore, it becomes essential for a just determination of this matter to have the testimony of Ellsworth T. Simpson, counsel of record, placed in evidence in order to

remove the element of closeness which, in the opinion of the Court, exists in this case.

WHEREFORE, the foregoing circumstances being considered, plaintiffs pray the allowance of the within motion.

Respectfully submitted,

ELLSWORTH T. SIMPSON
Attorney of Record for Plaintiffs
917 Fifteenth Street, N. W.
Washington, D. C.

Clerk's Office
Washington, D. C., October 2, 1956

To Attorney of Record and Assistant Attorney General, and Commissioner .....

Sirs:

Please take notice that in the above-entitled cause there has been entered this day on the plaintiff's motion for new trial the following order:

Overruled.

Respectfully,

WILLARD L. HART
Clerk, Court of Claims.

APPENDIX D

Stipulation of Facts, Paragraph 8 Only

8. In December 1946, plaintiff, although never a stockholder, loaned to the Quonset Inn, Inc., a restaurant and night club, the sum of $49,100. During the year 1947, plaintiff loaned further sums totaling $54,516.40 to the aforesaid corporation and in January 1948, he made a

further loan of $10,000. As of February 1, 1948, the Quonset Inn, Inc., was indebted to plaintiff in the total sum of $113,616.40, at which time he took over all the corporate assets and assumed its liabilities. On such date, February 1, 1948, the debt exceeded the net book value of the assets by $43,159.99. Plaintiff continued to operate the restaurant and night club as an individual proprietorship until April 30, 1949, at which time he sold its inventories of food and liquors and leased the equipment and premises to other parties at a stipulated rental. The business was not profitable when operated by the corporation or during the time plaintiff operated it as a single proprietorship for he continued to advance funds to pay the debts incurred after taking over the assets and before April 30, 1949.

APPENDIX E

Exhibit A to Statutory Notice of Deficiency

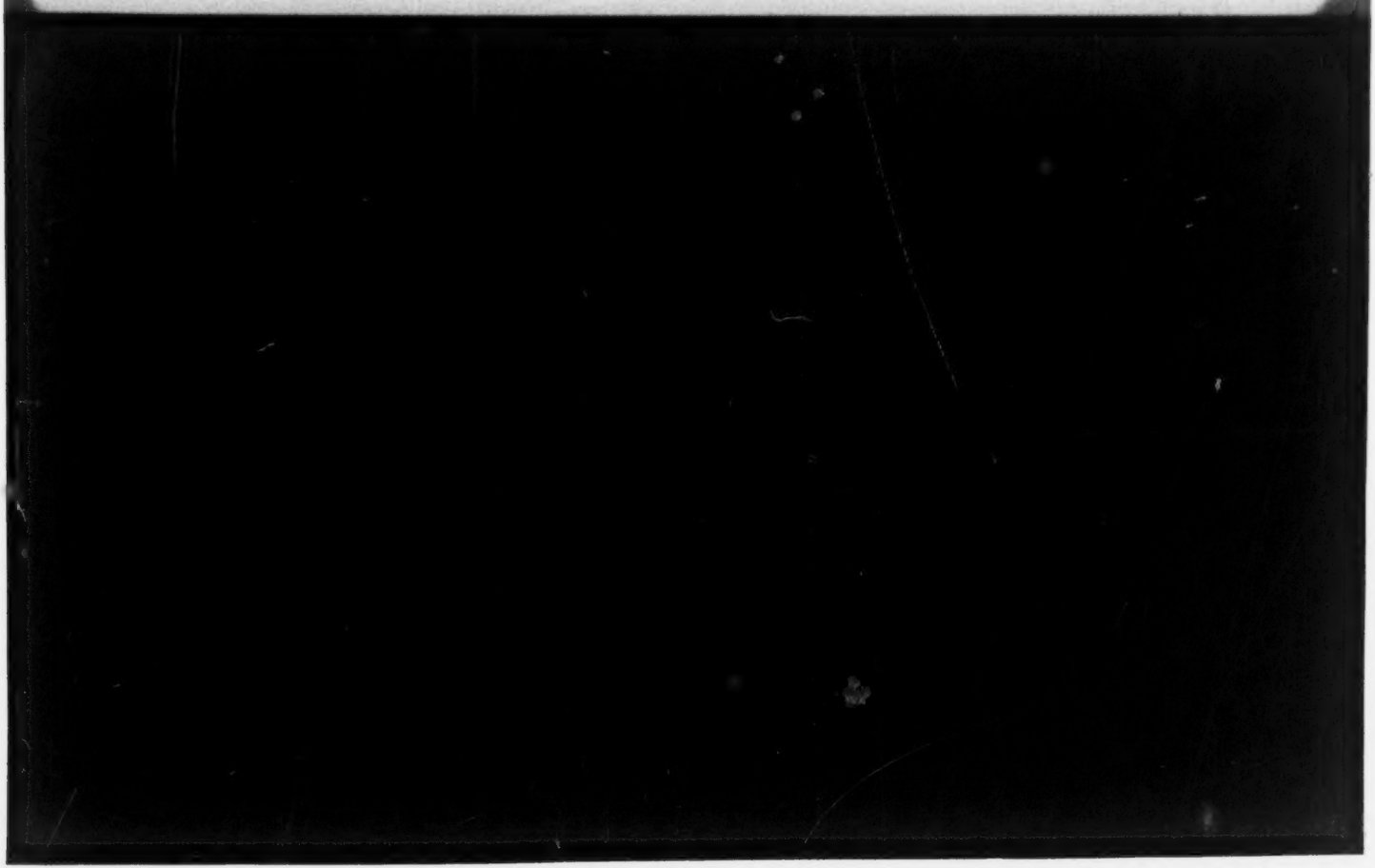
Theodore A. & Alice V. Meyers — STATEMENT OF NET WORTH

ASSETS	12/31/42	12/31/43	12/31/44	12/31/45	12/31/46	12/31/47	12/31/48	12/31/49	12/31/50
Cash on Hand	50,000.00	58,722.93	60,318.24	60,029.48	48,084.77	19,211.39	.....	40,367.60	41,640.51
Checking Account, City Bank, Mr. Meyers	3,521.64	2,481.34	4,030.99	71.50	69.52	57.55	57.77	53.77	47.99
Checking Account, City Bank, Mr. Meyers	.....	.....	.....	2,612.79	545.72	6,717.65	1,405.30	98.76	39.28
U. S. Government Bonds	825.00	2,550.00	7,893.75	8,268.75	8,268.75	8,268.75	8,268.75	8,268.75	8,268.75
Cars	1,800.00	1,800.00	1,800.00	1,800.00	3,350.00	4,500.00	4,500.00	5,733.09	5,609.09
Furniture	4,300.00	4,300.00	4,300.00	4,500.00	4,500.00	4,500.00	4,500.00	4,500.00	4,500.00
Jewelry	635.00	1,235.00	1,235.00	1,235.00	1,235.00	1,235.00	1,235.00	1,235.00	1,235.00
Furs	.....	.....	.....	2,750.00	2,750.00	3,225.00	3,225.00	3,225.00	3,225.00
Loans Receivable; Quonset Inn, Inc.	.....	.....	.....	.....	49,100.00	90,616.40	.....	.....	.....
Notes Receivable; Quonset Inn, Inc.	.....	.....	.....	.....	.....	13,000.00	.....	.....	.....
Investment in Quonset Inn	.....	.....	.....	.....	.....	.....	81,914.28	71,717.15	.....
Matthew Loan	.....	.....	.....	.....	1,000.00	2,000.00	2,000.00	2,000.00	2,000.00
Novak Loan	.....	.....	.....	.....	.....	.....	20,500.00	3,000.00	3,000.00
Mortgage Receivable	.....	.....	.....	.....	400.00	400.00	.....	.....	.....
Thompson Loan	.....	.....	.....	.....	.....	.....	.....	.....	600.00
Real Estate									
4240 Branch Avenue, S. E.	17,500.00	17,500.00	17,500.00	17,500.00	17,500.00	17,500.00	17,500.00	17,500.00	17,500.00
Temple Hills Real Estate	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00
3515 & 3601 Branch Avenue, S. E.	.....	.....	30,000.00	30,000.00	30,000.00	30,000.00	30,000.00	30,000.00	12,000.00
Colebrook Tract	.....	.....	.....	.....	2,500.00	2,500.00	2,500.00	2,500.00	2,500.00
Beverly Beach Lot	.....	.....	.....	.....	1,900.00	1,900.00	1,900.00	1,900.00	1,900.00
Lot on Silver Hill Road	.....	.....	.....	.....	.....	.....	.....	3,500.00	3,500.00
Farm Land	.....	.....	2,100.00	5,100.00	5,100.00	5,100.00	5,100.00	5,100.00	5,100.00
Farm Buildings	.....	.....	900.00	1,000.00	1,000.00	2,000.00	3,000.00	3,000.00	7,127.45
Cost of Clearing Farm Land	.....	.....	.....	.....	.....	.....	.....	.....	2,094.75
Farm Equipment	.....	.....	.....	.....	.....	.....	.....	.....	2,462.08
Loan Receivable, Quonset, Inc.	.....	.....	.....	.....	.....	.....	.....	.....	7,634.36
Quonset Inn Coin Machine	.....	.....	.....	.....	.....	.....	.....	2,770.00	3,973.76
5 Cattle	.....	.....	.....	.....	.....	.....	.....	.....	850.00
Quonset Inn Prepaid Rent	.....	.....	.....	.....	.....	.....	.....	.....	2,000.00
Quonset Inn Dishes & Equipment	.....	.....	.....	.....	.....	.....	.....	.....	3,000.00
Quonset Utility Deposit	.....	.....	.....	.....	.....	.....	.....	.....	410.00
Quonset Inn Equipment & Leasehold Improvements	.....	.....	.....	.....	.....	.....	.....	.....	59,531.40
TOTAL ASSETS	83,581.64	93,589.27	135,077.98	139,867.52	182,303.76	217,731.74	192,606.10	211,469.12	206,749.43

LIABILITIES	12/31/42	12/31/43	12/31/44	12/31/45	12/31/46	12/31/47	12/31/48	12/31/49	12/31/50
Mortgages									
Temple Hills Property	1,044.15	.....	.....	.....	.....	.....	.....	.....	.....
3515 & 3601 Branch Avenue, S. E.	.....	.....	27,112.04	26,317.24	25,473.28	24,577.32	23,626.00	22,616.08	21,543.84
Loan Payable	.....	.....	.....	.....	10,000.00	10,000.00	10,000.00	10,000.00	.....
Note Payable Fort Lincoln Cemetery	.....	.....	.....	.....	.....	.....	.....	.....	7,634.36
Depreciation Reserve									
Temple Hills House	.....	80.00	160.00	240.00	320.00	400.00	480.00	560.00	640.00
Farm Buildings	.....	.....	.....	.....	.....	75.00	150.00	225.00	418.79
Cattle	.....	.....	.....	.....	.....	.....	.....	.....	91.07
Farm Equipment	.....	.....	.....	.....	.....	.....	.....	.....	246.21
Coin Machines	.....	.....	.....	.....	.....	.....	.....	.....	1,280.14
TOTAL LIABILITIES	1,044.15	80.00	27,272.04	26,557.24	35,793.28	35,052.32	34,256.00	33,401.08	31,854.41
Net Worth	82,537.49	93,509.27	107,805.94	113,310.28	146,510.48	182,679.42	158,350.10	178,068.04	174,895.02
Prior Year		82,537.49	93,509.27	107,805.94	113,310.28	146,510.48	182,679.42	158,350.10	178,068.04
Net Worth Increase or Decrease		10,971.78	14,296.67	5,504.34	33,200.20	36,168.94	(24,329.32)	19,717.94	(3,173.02)
*Federal Income Tax Paid		19,093.30	3,472.14	6,557.79	6,221.60	28,813.26	40,074.82	(7,162.90)	4,888.88
Bail Bond & Attorney Fees		.....	.....	.....	.....	.....	3,366.66	.....	.....
Non deductible Losses		.....	.....	.....	.....	.....	43,159.99	605.91	1,039.00
Non Taxable Capital Gain		.....	.....	.....	.....	.....	.....	.....	(25,598.00)
Allowable Capital Loss		.....	.....	.....	.....	.....	(1,000.00)	(1,000.00)	(1,000.00)
Personal Checks—Mrs. Meyers		1,830.97	5,546.40	4,639.75	6,075.53	2,596.84	8,612.35	5,707.54	3,106.90
Personal Checks—Mr. Meyers		.....	.....	.....	.....	.....	.....	4,400.00	500.00
Estimated Cash Personal Expense		2,500.00	1,000.00	1,000.00	1,000.00	4,000.00	2,000.00	4,500.00	7,000.00
Gambling Losses		.....	.....	.....	.....	.....	.....	.....	5,000.00
Net Income Corrected		34,396.05	24,315.21	17,701.88	46,497.33	71,579.04	71,884.50	26,768.49	(8,236.24)
Per Return		34,396.05	24,315.21	17,701.88	46,497.33	71,579.04	22,489.87	27,768.49	3,346.88
Reduction and Additional Income		—0—	—0—	—0—	—0—	—0—	$49,394.63	($1,000.00)	($11,583.12)

* *Taxes Paid*

1948		1949		1950	
1947 Estimated Tax	$ 5,000.00	1948 Estimated Tax	$ 5,000.00	Final Payment 1949 Tax	$ 3,688.88
1947 Final Tax Payment	20,074.82	1949 Estimated Tax	3,000.00	1950 Estimated Tax	1,200.00
1948 Estimated Tax	15,000.00	Refund on 1948 Tax	(15,162.90)		
	$40,074.82		$ 7,162.90		$ 4,888.88



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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 634

THEODORE A. MEYERS AND WIFE, ALICE V. MEYERS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions and findings of fact of the Court of Claims (R. 1a–20a)[1] are reported at 134 F. Supp. 520 and 142 F. Supp. 365.

JURISDICTION

The judgment of the Court of Claims was entered on July 12, 1956. (R. 13a, 15a.) The taxpayers'[2]

[1] Record references are to the Appendix to the taxpayers' brief.

[2] Mrs. Meyers' activities and income are not in controversy, and she is interested only because joint returns were filed for the years in question; therefore, Mr. Meyers alone will hereinafter be referred to as the taxpayer.

motion for rehearing was denied on October 2, 1956. (R. 33a.) The petition for a writ of certiorari was filed on December 17, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255 (1).[3]

QUESTIONS PRESENTED

1. Whether, as held by the court below, the Commissioner of Internal Revenue's determination of a deficiency in the taxpayer's income tax for the year 1948 by use of the net worth method is supported by the evidence and is not arbitrary.

2. Whether the action of the court below in denying the taxpayer's motion for rehearing, which motion was made after the court had previously remanded the case to its Commissioner to take such further proof as either party might desire to offer, constituted a denial of due process of law.

STATUTES INVOLVED

The pertinent provisions of Sections 22 (a), 41, 51 (b), 54 (a) and 293 (a) of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra,* pp. 12–13.

STATEMENT

The facts, as found by the Court of Claims (R. 6a-13a, 15a–19a), may be summarized as follows:[4]

The taxpayer sued in the Court of Claims to recover $29,439.33, representing an income deficiency

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[3] The statement in the petition, p. 2, that jurisdiction is "invoked under 28 U. S. C. 1254 (1)" is obviously in error.

[4] Since the only year now in controversy is the calendar year 1948, the statement will be confined to facts pertinent thereto.

for the calendar year 1948 and a negligence penalty and interest. (R. 13a–14a).

From 1925 to 1934 the taxpayer operated gambling establishments in Washington, D. C. From 1937 to September, 1947, the taxpayer operated a gambling establishment at Silver Hill, Maryland. On June 5, 1948, the taxpayer was arrested in connection with a gambling raid and he had no gambling income thereafter in 1948. On his 1948 federal income tax return he reported the sum of $56,600 as income from wagering. (R. 6a–7a.)

On March 6, 1952, a 90-day letter setting forth computations of tax liability for 1948 was mailed to the taxpayer. The net worth method was used in the computation of the deficiency in tax for this year because the taxpayer had not maintained books and records which adequately and correctly reflected his taxable income. (R. 8a–9a.) (This liability had been paid by the taxpayer on February 20, 1952 pursuant to a jeopardy assessment of February 8, 1952. (R. 8a, 12a).) On March 14, 1952, the taxpayer filed a claim for refund in the amount of $34,276.43 for the year 1948. It was therein alleged that through error the taxpayer had failed to claim the following deductions: payment of Maryland income tax, $1,-848.96; loss on stolen hogs, $1,500; and loss on financing the Quonset Inn, $43,159.99—a total of $46,508.95. The loss on the Quonset Inn was claimed as a business bad debt. (R. 8a, 9a.) The claim for refund also attacked as being arbitrary the opening cash net worth figure as determined by the Commissioner of

Internal Revenue for the year 1948, i. e. $19,211.39. (R. 9a, 13a.)

The claimed deduction for Maryland income taxes paid in 1948 was allowed by the revenue agent in his net worth determination of taxable income. There was no available information concerning claimed income from hog raising. On the net worth statement no value for hogs was included for 1948. By reason of such exclusion, there would be no deductible loss from hog raising. (R. 9a–10a.) The Commissioner of Internal Revenue conceded in the 90-day letter that the $43,159.99 Quonset Inn item was a non-business bad debt allowable as a capital loss deduction to the taxpayer to the extent provided by the Internal Revenue Code. (R. 10a, 36a.)

Special Agent for the Internal Revenue Service, E. Russell Kennedy, Jr., had begun a preliminary inspection in late 1948 of the federal income tax returns filed by the taxpayer for the years 1943 through 1947. Certain books and records of the taxpayer were examined along with the income tax returns. The taxpayer's counsel also submitted a net worth statement which covered the years 1943 through 1947 and which was prepared in 1949. The special agent examined this statement and the records that were available, as well as the returns, and discussed the same with the taxpayer's counsel over a period of months. (R. 16a.)

The net worth statement supplied by the taxpayer to Special Agent Kennedy disclosed that as of December 31, 1942, the taxpayer had cash on hand of

$50,000 and on December 31, 1947, had cash on hand of $40,000. (R. 16a.) [5]

A second net worth statement was prepared by Special Agent Charles E. Thomas. Agent Thomas used the same assets and liabilities as had been submitted by taxpayer, and although his net worth statement was more detailed than the one supplied by the taxpayer, both statements reflected items which were substantially the same for each of the years 1942 through 1946. (R. 17a.)

The taxpayer contended at the second hearing that for the year ended December 31, 1947, the base year for purposes of determining the taxpayer's taxable income for the year 1948, his cash on hand was $40,000, the amount shown on his net worth statement.

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[5] Special Agent Kennedy testified at the second hearing of the case. (R. 14a.) On the first hearing the only contention of the taxpayer was that the opening cash for 1948 of $19,211.39 as determined by the Commissioner of Internal Revenue in the net worth statement was arbitrary and that this sum should be $70,000. The taxpayer, however, introduced no evidence to substantiate this figure. The Government likewise offered no evidence to explain the reasons for the difference between the sum of $19,211.39 cash on hand as of December 31, 1947 as determined by the Commissioner and $40,000 cash on hand as of this time as per the statement supplied by taxpayer. (R. 5a.) The court, therefore, concluded that although on the record the use of a net worth computation might be proper, the Commissioner's determination lacked the presumption of correctness. (R. 6a.) The taxpayer, suing for refund, introduced no evidence on this matter. In this state of the evidence, the court below could not properly enter judgment for either party and, therefore, remanded to its Commissioner to take the testimony of Agent Kennedy and to have the net worth statement used by him put in evidence, "and the taking of such further proof as either party may desire to offer, and for a supplemental report on the record so made." (R. 6a.)

The Government claimed it was $19,211.39. (R. 14a–15a.)

The net worth statement used by Agent Kennedy and the taxpayer refers to loans receivable (from Quonset Inn, Inc.) of $43,676.40 in 1947. This item was in error on this statement because it was established that additional loans had been made in 1947. Upon the correction of the omission relating to the amount of cash loaned during 1947 to Quonset Inn, Inc., the taxpayer's net worth statement supplied in 1949 would show, and the detailed net worth statement made by Agent Thomas did show, a decrease in the available cash on hand as of December 31, 1947, from the sum of $40,000 first determined to the sum of $19,211.39. Thus, when the error is corrected and necessary adjustments are made, the net worth statements of Agent Thomas and the taxpayer are not inconsistent. (R. 14a, 16a–18a.)

The net worth computations showing increases in net worth and the Commissioner's determination of income for the year in question are found at pages 35a–36a of the Appendix to the taxpayer's brief. In computing the taxpayer's taxable net income of $71,884.50 for the year 1948, prior to deducting the personal exemption and credit for dependents, there was added to net worth expenditures in the amount of federal income tax paid during 1948, bail bond and attorney fees, personal checks of Mrs. Meyers, and estimated personal cash expenses. There was also added the amount of the nondeductible loss of $43,159.99, less $1,000, which was the amount of the capital loss allowable on this transaction. This resulted in the amount

nation of an income tax liability of $28,889.92 for the year 1948. Since the taxpayer had reported a tax liability of $4,837.10, the deficiency was $24,052.82, upon which a five per cent negligence penalty was imposed. (R. 12a.)

The Court of Claims found as a fact that the use of the figures $50,000, cash on hand December 31, 1942, and $19,211.39, cash on hand as of January 1, 1948, was supported by the evidence as reasonable under the circumstances described; that the taxpayer's claim to have had $40,000, cash on hand as of December 31, 1947, was not supported by the evidence; and that the Government's use of the net worth method was supported by the evidence and was not arbitrary. (R. 14a–15a.)

ARGUMENT

This case presents only factual issues not warranting review by the Court. Moreover, the decision below is not in conflict with any other decision.

1. The court below was clearly correct in sustaining the Commissioner of Internal Revenue use of the net worth method in computing the taxpayer's income. The taxpayer's records, for the most part, derived from compiling and in order to keep adequate books and records or in order to enable the Commissioner to determine the correct amount of his taxable income. *United States*, 348 U. S. [illegible]; *United States*, 348 U. S. 142; *Holland* [illegible] 348 U. S. 121; *Doll* v. *Glenn*, [illegible]; *Laputka* v. *Commissioner*,

[illegible] denied, 350 U. S. [illegible], 289 F. 2d 822 (C. A. [illegible]th), certiorari denied, 348 U. S. 912; *Glenn* v. *Kentucky Color & Chemical Co.*, 186 F. 2d 975 (C. A. 6th). The examination of the taxpayer's prior tax history in arriving at an opening net worth is sustained by the authorities.[6] The Commissioner's computation was supported by the taxpayer's own evidence including his net worth statement. *United States* v. *Calderon*, 348 U. S. 160; *Smith* v. *United States*, *supra*; *Warring* v. *United States*, 222 F. 2d 906 (C. A. 4th), certiorari denied, 350 U. S. 861.

In this case the Commissioner of Internal Revenue's determination of deficiencies was presumptively correct and the taxpayer had the burden of proving it wrong. *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Reinecke* v. *Spalding*, 280 U. S. 227; *Koscove* v. *Commissioner*, 225 F. 2d 85 (C. A. 10th); *Staudt* v. *Commissioner*, 216 F. 2d 610 (C. A. 4th); *Carmack* v. *Commissioner*, 183 F. 2d 1 (C. A. 5th), certiorari denied, 340 U. S. 875. The taxpayer has not discharged that burden. Petitioner takes issue (Pet. 9–11) with the finding as to the amount of cash on hand at the beginning of the 1948 net worth period. The taxpayer claimed that the figure should be $40,000 (R. 14a);[7] the record, however, discloses no evidence substantiating this claim. The Court of Claims

[6] *Friedberg* v. *United States*, *supra*; *Holland* v. *United States*, *supra*; *Kampmeyer* v. *United States*, 227 F. 2d 313 (C. A. 8th), certiorari denied, 351 U. S. 904; *Vlautis* v. *United States*, 219 F. 2d 782 (C. A. 5th); *Leeby* v. *United States*, 192 F. 2d 331 (C. A. 8th).

[7] As noted *supra* p. 5, fn. 5, at the first hearing the taxpayer claimed this figure to be $70,000. (R. 4a.)

considered the case on two separate occasions and, after careful deliberation, sustained the Commissioner of Internal Revenue's figure of $19,211.39 as reasonable and as supported by the evidence.

Helvering v. *Taylor,* 293 U. S. 507, relied on by the taxpayer (Pet. 10), does not support his position in this connection. In the present case the Commissioner of Internal Revenue's computation was clearly not arbitrary. On the contrary, the record shows and the Court of Claims found that the Commissioner's determination of taxpayer's tax liability for the year 1948 was supported by the evidence. That court further found that the taxpayer's claim had no support in the evidence. (R. 15a.)

The taxpayer's additional contention (Pet. 8–9), that the computation of the amount of his net income for the year 1948 was incorrect because a non-business bad debt loss was included in his net worth, was not presented to the court below. The issue the taxpayer now advances was never open to him; he gave no notice of such claim and refers to no facts upon which it may be founded on his claim for refund.[8] *United*

[8] The only issue raised in the refund claim, and therefore the only issue before the trial court, regarding this bad debt loss was whether it could be taken as a business bad debt loss or as a non-business bad debt loss (capital loss). (R. 9a–11a.) The Court of Claims found with the Government that it was a non-business loss, since the taxpayer conceded the issue by offering no argument nor evidence, in brief or otherwise, on the matter. Furthermore, the taxpayer conceded that the Commissioner of Internal Revenue's figures and his own were in complete agreement except for cash on hand December 31, 1947. This was the only contention in this respect made in the refund claim. The court below, not having before it the new issue in the case nor any evidence upon such issue, necessarily made no findings on the premises now advanced.

States v. *Felt & Tarrant Co.*, 283 U. S. 269; *Ney* v. *United States*, 171 F. 2d 449, 451 (C. A. 8th), certiorari denied, 336 U. S. 967; *B. F. Goodrich Co.* v. *United States*, 135 F. 2d 456 (C. A. 9th), affirmed, 321 U. S. 126, rehearing denied, 321 U. S. 803. His petition before the Court of Claims likewise made no mention of this present contention nor did it allege facts that would support it. After the first hearing, the court below remanded and gave an opportunity to introduce additional evidence such "as either party may desire to offer". (R. 6a.) Again, the taxpayer stood mute. Finally, the taxpayer in his motion for rehearing did not advance his present contention nor refer to any evidence that would substantiate it. The taxpayer was given more than his full day in court. A settled rule of this Court precludes the consideration of questions not raised or disclosed by the record brought to it for review and which were not considered by the court below. This rule is strictly adhered to in cases originating in the Court of Claims. *Standard-Vacuum Oil Co.* v. *United States*, 339 U. S. 157, 159; *Hathway & Co.* v. *United States*, 249 U. S. 460, 464; *Huse* v. *United States*, 222 U. S. 496, 505. Moreover, the extent of the increase in net worth was a matter for resolution by the trier of the facts and, therefore, presents no issue reviewable here.

In any event, the inclusion of the non-business bad debt loss in the computation of taxpayer's taxable income was entirely proper. If this item had not been included, taxable income would have been decreased by the amount of the non-deductible loss. Thus, if the

amount of this loss were not included, taxpayer would, in effect, be allowed to deduct the non-deductible item. A decrease in assets caused by a non-deductible loss, like an expenditure, must be added to net worth to determine the true taxable income for the period.

2. The taxpayer's due process contention (Pet. 2) likewise lacks merit. It is settled law that no appeal lies from an order denying a motion for rehearing. *Wayne Gas Co.* v. *Owens Co.*, 300 U. S. 131, 137. Furthermore, taxpayer's motion was made after the court below had once remanded to its Commissioner to give the parties an opportunity to submit such further proof as they "may desire". (R. 6a.) The court in its initial opinion, in which it remanded, put the taxpayer on notice that his evidence "is not clear or complete enough to justify a decision for him." (R. 6a.) On remand the taxpayer offered no further evidence.

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be denied.

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JANUARY 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C., 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26 U. S. C., 1952 ed., Sec. 41.)

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) (as amended by Sec. 303 of the Revenue Act of 1948, c. 168, 62 Stat. 110) *Husband and Wife.*—

(1) *In General.*—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

* * * * *

(26 U. S. C., 1952 ed., Sec. 51.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C., 1952 ed., Sec. 54.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) *Negligence.*—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

* * * * *

(26 U. S. C., 1952 ed., Sec. 293.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 634

THEODORE A. MEYERS and wife, ALICE V. MEYERS,
Petitioners

v.

THE UNITED STATES, *Respondent*

REPLY BRIEF FOR PETITIONERS

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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JURISDICTION

The judgment of the Court of Claims was entered October 2, 1956 (R. 33a).[1] Jurisdiction of this Court is invoked under 28 U.S.C., Section 1255 (1). In the Petition, the section was inadvertently referred to as 1254 (1).

---

[1] Record references are to petitioners' brief.

QUESTIONS PRESENTED

I. Whether the Court below, by its decision, sanctioned the taking of property in an arbitrary manner by upholding a patently defective net worth computation employed by the Commissioner of Internal Revenue in determining petitioners' income tax liability for the calendar year 1948.

II. Whether the increasing of petitioners' net worth for the calendar year 1948 by adding thereto a non-business bad debt in the amount of $43,159.99, sustained in such year upon investments made in prior years and for which no deduction was claimed by petitioners, constitutes such an arbitrary determination and collection of taxes that, if permitted to stand, the judgment of the Court below would do violence to the concept of fairness and equality upon which our system of jurisprudence is founded.

III. Whether the Court below, by refusing to permit petitioners "to explain the discrepancies in the case," referred to by the Court below in its opinion, constitutes a substantial denial of due process of law.

STATUTES INVOLVED

The applicable provisions of the Internal Revenue Code (1939) appear at pages 3-5 of the Petition.

STATEMENT

In summarizing the facts, as found by the Court of Claims, respondent neglected to mention that the 90-day letter referred to on page 3 of its brief, and also found as one of the facts by the Court below (R. 8a), reflected an over-reporting of income by the petitioners for two successive years following that for

which a deficiency had been determined. Respondent presumably sought to avoid this fact on the alleged grounds that only the calendar year 1948 is now in controversy. The fact is, however, that the deficiency for 1948, as actually determined, could not exist without creating overpayments of taxes for the calendar years 1949 and 1950. These two years, therefore, are an integral part of this case.

Relative to the non-business bad debt in the amount of $43,159.99 (which sum was actually added to petitioners' income for the year 1948), respondent failed to mention that this sum was found by the Court below to represent a decrease in the net book value of the corporate assets of Quonset Inn, Inc., as of February 1, 1948, at which time petitioners took over all of the corporate assets and assumed its liabilities. Briefly, the Court of Claims found that the debt owed by Quonset Inn, Inc., to petitioners exceeded the net book value of its assets by $43,159.99 (R. 10a).

Footnote 5, page 5, of respondent's brief contains a statement at variance with the record. Contrary to respondent's claim, Petitioners did offer evidence as to the amount of cash on hand as of December 31, 1942 as well as the amount on hand as of December 31, 1947. This evidence was in the form of oral testimony of petitioner, T. A. Meyers, who testified at both hearings.

On pages 5, 6 and 7 of its brief, respondent has substantially repeated the findings of the Court of Claims as they related to the question of the item of cash on hand as of December 31, 1942 and December 31, 1947. The evidence introduced by respondent, in whose possession it had always been since early 1949 (re-

spondent refused to produce it at the first hearing), reflected cash on hand in the amount of $50,000 as of December 31, 1942 and $40,000 as of December 31, 1947. At the second hearing, respondent contradicted a portion of this evidence to the extent that it adopted the figure of $50,000 contained in such evidence and rejected the figure of $40,000 which was also reflected therein as representing cash on hand as of December 31, 1947. The Court of Claims found as a fact that the $50,000 was supported by the evidence and, even though the sum of $40,000 is part and parcel of this same evidence, the Court below found that the sum of $40,000 was not supported by the evidence. In finding that the $40,000, as cash on hand as of December 31, 1947, was not supported by the evidence, the Court below predicated such finding upon assumptions which, in turn, constitute the basis upon which that Court concluded that the net worth method was not arbitrary and capricious (R. 25a and 28a).

ARGUMENT

Respondent contends that this case presents only factual issues not warranting review by this Court. This contention, of course, is not necessarily an accurate one. Furthermore, when, as in this case, the record unequivocally demonstrates that the decision of the Court below is based on so-called facts which have been erroneously drawn from the record, then the record itself should be determinative of such a question. Respondent also argues that the Court below was clearly correct in sustaining the Commissioner of Internal Revenue's use of the net worth method in computing the taxpayers' income. In support of this argument, respondent cites the following cases: *Smith*

v. *United States,* 348 U. S. 147; *Friedberg* v. *United States,* 348 U. S. 142; *Holland* v. *United States,* 348 U. S. 121; *Doll* v. *Glenn,* 231 F. 2d 186 (C. A. 6th); *Lipsitz* v. *Commissioner,* 220 F. 2d 871 (C. A. 4th), certiorari denied, 350 U. S. 845; *Bryan* v. *Commissioner,* 209 F. 2d 822 (C. A. 5th), certiorari denied, 348 U. S. 912; *Glenn* v. *Kentucky Color & Chemical Co.,* 186 F. 2d 975 (C. A. 6th).

The cases thus relied upon fail to bear any factual resemblance to the one under consideration. In the instant case, the petitioners' Federal income tax returns for the years 1943 to 1947, inclusive, had been accepted by the Commissioner of Internal Revenue as correctly reporting their income for those years; there was no progressive increase in petitioners' net worth in excess of the net taxable income reported by them. Moreover, in the instant case, respondent is obliged to concede that petitioners over-reported their income in the two years immediately following the calendar year 1948. It was necessary to create this over-reporting in order for the Commissioner of Internal Revenue to determine a deficiency for the calendar year 1948. None of the cases cited by respondent contains such facts. It is contended on the part of respondent that the examination of the taxpayers' prior tax history in arriving at an opening net worth is sustained by the authorities. The cases cited in support thereof are as follows: *Friedberg* v. *United States, supra; Holland* v. *United States, supra; Kampmeyer* v. *United States,* 227 F. 2d 313 (C. A. 8th), certiorari denied, 351 U. S. 904; *Vloutis* v. *United States,* 219 F. 2d 782 (C. A. 5th); *Leeby* v. *United States,* 192 F. 2d 331 (C.A. 8th). The Commissioner's computation is not supported by tax-

payers' own evidence, including his net worth statement, for the reason that the Commissioner has actually rejected the taxpayers' net worth and superimposed certain adjustments thereon which in and of themselves unquestionably reveal the arbitrary and capricious character of the Commissioner's net worth. The cases relied upon by respondent in this regard are clearly distinguishable from the one in issue. *United States* v. *Calderon*, 348 U. S. 160; *Smith* v. *United States, supra; Warring* v. *United States*, 222 F. 2d 906 (C. A. 4th), certiorari denied, 350 U. S. 861.

The opening net worth for the calendar year 1948 should be the closing net worth for the calendar year 1947. This closing net worth (R. 20a, para. 3) reflected cash on hand in the amount of $40,000; this sum, however, was rejected notwithstanding the fact that it had been previously accepted by the Commissioner of Internal Revenue in accepting petitioners' income tax returns for the years 1943 to 1947, inclusive.

Petitioners are well aware of the principle that the determination of the Commissioner of Internal Revenue is presumptively correct and that they have the burden of proving that it is wrong. The following cases were cited by respondent in support of this principle: *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Reinecke* v. *Spalding*, 280 U. S. 227; *Koscove* v. *Commissioner*, 225 F. 2d 85 (C. A. 10th); *Staudt* v. *Commissioner*, 216 F. 2d 610 (C. A. 4th); *Carmack* v. *Commissioner*, 183 F. 2d 1 (C. A. 5th), certiorari denied, 340 U. S. 875. Again, as is also true of the many other cases cited by respondent, the facts in the cases cited are so dissimilar from those in the present proceeding that the principles enunciated therein can have no application to this case. As a

matter of fact, the Supreme Court of the United States, in the case of *Helvering* v. *Taylor,* 293 U. S. 507, clearly stated that such determination will not be supported when it is shown to be without rational foundation. The decision of the Court below, therefore, is in direct conflict with the decision of this Court in that case.

For the purpose of demonstrating that the Commissioner's determination has no rational foundation it is necessary only to employ the principles of elementary arithmetic. First of all, the Court of Claims (R. 11a, para. 17) found that the net worth statement required $19,211.39 as cash on hand as of December 31, 1947 to make the net income coincide with the $71,579.04 which was reported as taxable income by the petitioners for the year 1947. The Court further stated that, "to give the taxpayers all possible benefits of cash, or the source of cash, it was reduced to zero as of December 31, 1948." If this statement is regarded as sound, how, it is asked, could the Court below also find, by sustaining the Commissioner of Internal Revenue in the overassessments for 1949 and 1950, that the petitioners had $40,367.60 as cash on hand as of December 31, 1949 and the sum of $41,640.51 as cash on hand as of December 31, 1950, and, at the same time, hold that petitioners overreported their income in 1949 by $1000, and in 1950 by $11,832.12? In other words, it is arithmetically impossible for petitioners to increase their cash from zero at the end of 1948 to the sum of $40,367.60 at the end of 1949, a period of 12 months, on a net taxable income, according to the Court below, of $26,768.49, and yet be regarded as having overreported their income on a net worth basis. This same condition pre-

vails, only more so, in the following year, where, it was found that petitioners' net taxable income in 1950 was actually a loss of $8,236.24 and that they again over-reported their income in that year. Secondly, a significant "fact" found by the Court below (R. 16a, paragraph 3) where, among other things, it is stated, "If on the other hand, they had more than $50,000 cash on hand on December 31, 1942, their income would have been less than that reflected by the net worth statement for the ensuing five years." If this is reduced to an absurdum, it might well be argued that, if the petitioners had $1,000,000 as cash on hand as of December 31, 1942, then, as the result of over-reporting their income, they are actually entitled to a refund for five consecutive years. The answer, however, is very simple, that is, if the petitioners actually had $1,000,000 as of December 31, 1942 then that asset is merely carried forward as a constant figure, and would be reflected in the net worth statement as of December 31, 1947. Not only is the determination of the Commissioner lacking in rational foundation, it goes beyond this; it does violence to principles of simple arithmetic. Thirdly, the inclusion of the non-business bad debt in the amount of $43,159.99 as income taxable to the petitioners in the year 1948 is another patent defect showing the determination to be without rational foundation. As to this feature of the net worth, respondent complains that petitioners did not present this contention to the Court below. The record is eminently clear that from the inception of this case, petitioners have contended that the net worth, as actually constructed, was arbitrary and capricious and that it lacked any support from the standpoint of basic arithmetic. Furthermore, the

stipulation of facts, paragraph 8 (R. 33a) establishes that the loan advanced by petitioners to Quonset Inn, Inc. was advanced to it prior to 1948 and that the sum of $43,159.99 represents an accounting loss because the net book value of that which petitioners received in 1948 was less, by that amount, than that which had been advanced in years prior to 1948. This fact was before the Court below. Petitioners are not now advancing any fact which was not before that Court.

Considering now the contention of respondent that the inclusion of the non-business bad debt in the computation of taxpayers' taxable income was entirely proper, we find that the reasoning upon which this statement is predicated deserves more than a cursory examination. Specifically, the respondent states, "If this item had not been included, taxable income would have been decreased by the amount of the non-deductible loss. Thus, if the amount of this loss were not included, taxpayer would, in effect, be allowed to deduct the non-deductible item. A decrease in assets caused by a non-deductible loss, like an expenditure, must be added to net worth to determine the true taxable income for the period." Ostensibly, such reasoning is specious and should be exposed for what it is. Respondent claims, "a decrease in assets, caused by a non-deductible loss, like an expenditure, must be added to net worth. . . . " First of all, an expenditure represents a physical outlay of money and, as such, must have had its origin in income, or, as in a net worth case, is presumed to have such origin and, therefore, such expenditure must be added to any increase in net worth in determining taxable income. When a loss is sustained in the same year in which the assets were acquired, the asset is presumed to have been acquired

from income received in that year, and, therefore, must be added to the net worth in order to preclude such taxable income from escaping taxation. Such is not the case here, however, these loans, representing loan receivables, had been advanced by petitioners prior to 1948 and, therefore, could not have had their origin in income for the calendar year 1948. When petitioners took over the assets of Quonset Inn, Inc. in 1948, the book value of such assets was $43,159.99 less than that which had been previously advanced. To add this economic loss to petitioners' income in 1948, as was actually done and sanctioned by the Court below, is not only arbitrary and capricious, it is tantamount to taking property by wrongful means under the guise of a net worth method. It should be mentioned that there is serious doubt with respect to the propriety of the employment of the net worth method in the instant case. The petitioners will not belabor this point and are willing to accept the responsibility of demonstrating the unreasonableness of the net worth method as constructed. Petitioners have diligently and patiently sought to point out the errors of this net worth, but the Court below, by virtue of inconsistent assumptions upon which certain facts were then found, has refused to recognize them.

As to whether petitioners have been denied due process, it should be observed that petitioners, for the first time, were informed that they had facts "peculiarly within their knowledge to explain the discrepancies involved in the case," when the Court of Claims issued its decision under date of July 12, 1956. Then, as now, the petitioners were at a loss to know precisely what the Court below meant by that statement. In an effort to ascertain this, petitioners'

counsel sought to give his testimony in the belief that the discrepancies referred to might possibly relate to the item of cash on hand in the original partial net worth. The discrepancies, it is submitted, are not peculiarly within the knowledge of petitioners, in fact, they stand in bold relief for all to see. They are the handiwork of the Commissioner of Internal Revenue and they have received the sanction and approval of the Court below. Moreover, such discrepancies form the very basis upon which petitioners have consistently contended that the net worth was arbitrary and capricious; that the net worth could be supported only by making erroneous and speculative assumptions which are later stamped with the label of "facts".

CONCLUSION

Based on the foregoing argument, and those contained in the petition, it is most respectfully submitted that a writ of certiorari should be granted in this case.

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